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THE PUBLIC POLICY AND MANDATORY RULES OF THIRD COUNTRIES IN INTERNATIONAL CONTRACTS

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A. Introduction

While party autonomy has risen in the field of contract, this autonomy is not unfettered. Parties are allowed to choose the governing law of the contract[1] but limitations on party choice can be seen through the operation of public policy and mandatory rules. The public policy and mandatory rules of three laws may be imposed onto the contract: that of the *lex fori*, the governing law of the contract and the law of a third country[2] with a connection to the contract. It is generally accepted that the public policy and mandatory rules of the forum have a legitimate role to play in the regulation of the contract.[3] Some continental, particularly German, theorists are more equivocal about whether the public policy and mandatory rules of the governing law of the contract have a similar legitimacy.[4] Nevertheless, the most controversial issue with regard to restrictions on party autonomy is whether the law of a third country is or should be given effect. This issue is the focus of this article.

The current position under English law is that the laws of third countries are not relevant owing to the reservation[5] against Article 7(1) of the Rome Convention on the Law Applicable to Contractual Obligations.[6] Germany, Luxembourg,

* Lecturer in Law, University of Nottingham. I would like to thank Prof. J. Fawcett and the editors of this journal for helpful comments made on earlier drafts of this article. All errors remain my own.

1 Article 3 of the Rome Convention on the Law Applicable to Contractual Obligations; *Vita Food Products Inc. v Unus Shipping Co Ltd* [1939] AC 277.

2 Ie, one that is neither the governing law of the contract nor the law of the forum.

3 Articles 7(2) and 16 of the Rome Convention.

4 See N Voser, "Mandatory Rules of Law as a Limitation on the Law Applicable in International Commercial Arbitration" (1996) 7 *American Review of International Arbitration* 319, 323. Cf. Max Planck Institute for Foreign Private and Private International Law, *Comments on the European Commission's Green Paper on the Conversion of the Rome Convention of 1980 on the Law Applicable to Contractual Obligations into a Community Instrument and its Modernization* (2004) *Rabels Zeitschrift* 1, 69; document also accessible online at: http://www.europa.eu.int/comm/justice_home/news/consulting_public/rome_i/doc/max_planck_institute_foreign_private_international_law_en.pdf (as on 23 February 2006) (page references in this article refer to the *RabelsZ* text).

5 Section 2(2) of the Contracts (Applicable Law) Act 1990.

6 Hereafter the "Rome Convention"; enacted into English law by the Contracts (Applicable Law) Act 1990.

Portugal and Ireland have also chosen not to enact Article 7(1) into their laws. However, the European Commission has recently published its proposal for a Regulation on the Law Applicable to Contractual Obligations, commonly known as the proposed Rome I Regulation.[7] One of the most interesting implications of this move to transpose the Rome Convention into a Regulation is that the successor to Article 7(1) of the Rome Convention may form part of the law of the United Kingdom and the other reserving States.[8] If this development comes to pass, should it be welcomed or resisted?

This article will first briefly consider the meaning of the two concepts of public policy and mandatory rules. Next, the key question of whether a third country's public policy and mandatory rules should be relevant in an international contract will be analysed. Case law regarding the relevance or otherwise of the law of a third country often involves the law of the place of performance. Hence, lastly, the role that is given to the *lex loci solutionis* will be examined to discover principles of general application.

B. Definitions of Public Policy and Mandatory Rules

The nature and operation of public policy and mandatory rules involve considerable intricacy and detailed expositions can be found elsewhere.[9] The object of this section is merely to give a general overview of these two concepts in order to lay the background for the in-depth analysis of the various issues concerning the laws of third countries that follows.

1. Public Policy

The concept of public policy has strong ethical associations. Cardozo J has put it thus:

[7] COM (2005) 650 final.

[8] The draft Article 8(3). See also Article 13(2) of the amended proposal for a Regulation on the Law Applicable to Non-Contractual Obligations (commonly known as the proposed Rome II Regulation) COM (2006) 83 final.

[9] See, eg, PB Carter, "The Role of Public Policy in English Private International Law" (1993) 42 *International and Comparative Law Quarterly* 1; TC Hartley, "Mandatory Rules in International Contracts: The Common Law Approach" (1997) 266 *Recueil des Cours* 341; F Mosconi, "Exceptions to the Operation of Choice of Law Rules" (1989-V) *Recueil des Cours* 19; F Vischer, "General Course on Private International Law" (1992-I) *Recueil des Cours* 21; D Jackson, "Mandatory Rules and Rules of 'Ordre Public'" in PM North (ed), *Contract Conflicts: The EEC Convention on the Law Applicable to Contractual Obligations – A Comparative Study* (Oxford, North-Holland Publishing Co, 1982) (hereafter *Contract Conflicts*); S Knofel, "Mandatory Rules and Choice of Law: A Comparative Approach to Article 7(2) of the Rome Convention" [1999] *Journal of Business Law* 239; N Enonchong, "Public Policy in the Conflict of Laws: A Chinese Wall Around Little England?" (1995) 45 *International and Comparative Law Quarterly* 633; A Briggs, "Public Policy in the Conflict of Laws: A Sword and a Shield?" (2002) 6 *Singapore Journal of International and Comparative Law* 953.

"The courts are not free to enforce a foreign right at the pleasure of the judges, to suit the individual notion of expediency or fairness. They do not close their doors unless help would violate some fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the commonweal."[10]

One generally speaks of forum public policy in relation to an international contract. However, in certain situations it appears that the public policy of a third country is relevant. This issue will be examined below.[11] For now, however, the focus will be on the more familiar idea of forum public policy in order to sketch out how the concept of "public policy" operates.[12]

There are two tiers of public policy: public policy that is applicable in a domestic context and public policy that is applicable even in an international context.[13] French civil lawyers use the phrases "ordre public interne" and "ordre public externe" respectively. It has been observed that the phrase "ordre public" has "a far less political connotation"[14] and "deeper roots"[15] than the parallel English phrase "public policy", and it is the wider civil law sense of the concept that is applicable in international conventions. The English text of the Hague Conventions as well as Article 16 of the Rome Convention includes the phrase "ordre public" to denote this fact.[16] However, there are no indications that the wider civil law sense of the concept is causing English courts any difficulty. In addition, in the field of contractual obligations, a comparative study between the French and English legal systems indicates that there is a "considerable similarity" between the French courts' approach and that of the English courts in the application of public policy.[17] Thus the practical differences between the civil

[10] *Loucks v Standard Oil Co* 120 NE 198 at 202 (1918).

[11] Section D.2.

[12] Public policy is a tenuous concept and as Vischer notes, "All attempts to establish a precise definition of the content of *ordre public* must fail. We cannot do more than indicate some general directions": *supra* n 9, 100–01.

[13] Domestic and international public policy are two aspects of the same thing in that both express the fundamental values of the forum; only their spheres of application differ: AN Zhilsov, "Mandatory and Public Policy Rules in International Commercial Arbitration" (1995) *Netherlands International Law Review* 81, 97. O Kahn-Freund argues that courts appear more keen to ascribe an *ordre public* international character to judge-made law than to statutes: *Selected Writings* (London, Stevens & Sons, 1978), 254.

[14] RH Graveson, *The Conflict of Laws* (London, Sweet & Maxwell, 7th edn, 1974), 165; quoted by Mosconi, *supra* n 9, 24.

[15] Mosconi, *supra* n 9, 24.

[16] A Diamond, "Harmonization of Private International Law Relating to Contractual Obligations" (1986) 199 *Recueil des Cours* 233, 292.

[17] FH Lawson, AE Anton, L Neville Brown, *Amos and Walton's Introduction to French Law* (Oxford, Clarendon Press, 3rd edn, 1967), 169. The main differences are that French courts frequently use French statutes as a source of public policy since French law is primarily statutory in character and they put emphasis on subjective rights and standards as opposed to the common law predilection for objective standards: D Lloyd, *Public Policy: A Comparative Study in English and French Law* (London, The Athlone Press, 1953), 7, 150. Cf HC Gutteridge, *Comparative Law: An Introduction to the Comparative Method of Legal Study & Research* (Cambridge University Press, 2nd edn, 1949), 98–100.

and common law concepts of public policy appear not to be of great relevance in international contracts.

Public policy comes into play at the last stage of the conflicts process, after operation of choice of law rules has identified the governing law. Forum sovereignty provides this "escape route",[18] in the sense that the forum is not obliged to give effect to foreign provisions which are against its principles. Indeed, it has been pointed out that if the forum were to recognize such foreign values, this:

> "would give rise, within itself, to profound contradictions much more dangerous than simple public disorders. It would potentially be able to stir up a situation of continuing conflict; in other words, that system would end up by negating its very essence of legal order."[19]

Under the common law, forum public policy operates under two heads: first, rejection of a foreign rule that is repugnant to English public policy;[20] and secondly, public policy that aims to maintain comity between the United Kingdom and other nations.[21] The operation of the first head is straightforward and is based on the idea of forum sovereignty mentioned above. The operation of the second head is more problematic as it has a bearing upon the interrelationship between public policy and mandatory rules. This issue will shortly be discussed in detail.[22]

Under the Rome Convention, Article 16 provides that:

> "The application of a rule of the law of any country specified by this Convention may be refused only if such application is manifestly incompatible with the public policy ('ordre public') of the forum."

Dicey and Morris observe that Article 16 is "precisely the same as the pre-existing English law in relation to contracts".[23] This may be true only in relation to the operation of the first head of public policy under the common law.[24]

[18] Carter, *supra* n 9, 1.

[19] N Palaia, *L'ordine pubblico "internazionale"* (Padua, CEDAM, 1974), 53; cited by Mosconi, *supra* n 9, 29.

[20] *Kaufman v Gerson* [1904] 1 KB 591; *Oppenheimer v Catermole* [1976] AC 249; *Rousillon v Rousillon* (1880) 14 Ch D 351; *Grell v Levy* (1864) 16 CB (NS) 73.

[21] *Foster v Driscoll* [1929] 1 K.B. 470; *Regazzoni v KC Sethia* [1958] AC 301. See L Collins, "Comity in Modern Private International Law" in J Fawcett (ed), *Reform and Development of Private International Law: Essays in Honour of Sir Peter North* (Oxford University Press, 2002), who probes the underlying basis of the doctrine of comity in modern private international law.

[22] Section B.3.

[23] Save for the inclusion of the phrase "manifestly incompatible": *Dicey and Morris on the Conflict of Laws* (London, Sweet & Maxwell, 13th edn, 2000) (hereafter "*Dicey and Morris*"), 1277 (para 32–229). However, their statement as to the consistency between the common law and the Rome Convention must be read subject to their interpretation of *Foster v Driscoll*. See *infra*, n 45.

[24] See discussion *infra* section B.3.

2. Mandatory Rules

Mandatory rules are imperative rules which apply to a contract irrespective of the parties' wishes. Nygh notes that the purpose of mandatory rules is twofold: to protect the interests of the State itself and to protect private interests that the State wishes to protect.[25] The increasing importance of mandatory rules can be attributed to the rejection of the idea that the governing law has to have some connection with the contract; mandatory rules now function as a tool to restrict party choice.[26]

The fundamental definition of mandatory rules is rules that cannot be "excluded, altered or limited by contract".[27] However, two types of mandatory rules must be distinguished. One is a type of mandatory rule which would be applicable when the governing law of the contract is also that of the law containing that particular mandatory rule. This category is known as domestic mandatory rules. They are mainly concerned with the creation of a coherent system of contract law; rules on offer and acceptance would be an example.[28] The second category encompasses a narrower, "stronger" category of rules which are applicable irrespective of the governing law of the contract. These are known as international mandatory rules or overriding mandatory rules. They have been defined by the European Court of Justice as being:

> "national provisions compliance with which has been deemed to be so crucial for the protection of the political, social or economic order in the Member State concerned as to require compliance therewith by all persons present on the national territory of that Member State and all legal relationships within that State."[29]

Typical examples are rules concerning exchange regulations, antitrust laws, and import and export prohibitions.[30] Under English law, an example of an international mandatory rule is section 27(2) of the Unfair Contract Terms Act 1977, which states that the Act applies to a contract notwithstanding a choice of a foreign law if (a) the foreign law was chosen "wholly or mainly for the purpose of enabling the party imposing it to evade the operation of this Act"; or (b) "in the making of the contract one of the parties dealt as consumer, and he was then habitually resident in the United Kingdom, and the essential steps necessary for the making of the contract were taken there, whether by him or by others on his behalf."

25 P Nygh, *Autonomy in International Contracts* (Oxford, Clarendon Press, 1999), 203.
26 Voser, *supra* n 4, 320.
27 Hartley, *supra* n 9, 345.
28 *Ibid*, 345–46.
29 *Arblade* (Case C–369/96) and *Leloup* (Case C–376/96) [1999] ECR I–8453, para 30. This passage formed the inspiration for the European Commission's definition of international mandatory provisions in Article 8(1) of the proposed Rome I Regulation: COM (2005) 650 final, 8.
30 Vischer, *supra* n 9, 157; Voser, *supra* n 4, 325.

However, identifying a mandatory rule as being either domestic or international in nature is not always an easy task. Statutes do not always set out their scope of application,[31] and common law mandatory rules are hard to define.[32] It is clear, though, that the law of the country from which a mandatory rule originates determines whether or not it is mandatory in the domestic sense or narrower, international sense.[33]

Both types of mandatory rules can be found in the Rome Convention.[34] Articles 3(3), 5(2)[35] and 6(1) concern domestic mandatory rules while Articles 7(1) and 7(2) refer to international mandatory rules. Article 7(2) concerns the application of the international mandatory rules of the forum while the other provisions relate to the application of the mandatory rules of third states. These latter provisions, and their counterparts in the proposed Rome I Regulation, will therefore be looked at in more detail below.[36]

3. Interrelationship Between Public Policy and Mandatory Rules

Even though public policy and mandatory rules form two different concepts, there is a fair amount of overlap between them. It is rightly said that mandatory rules are, in a sense, an expression of public policy[37] as the values which mandatory rules aim to promote are often of a public policy nature.[38] The generally accepted dividing line between the two is that public policy operates negatively in that it involves the disapplication of the relevant applicable law,[39] while mandatory rules operate positively in that they are superimposed onto the applicable law of the contract. However, the distinction between the two concepts is sometimes not clear cut in practice. Kahn-Freund has argued that there is a

[31] Apart from the Unfair Contract Terms Act 1977, other English statutes which have provisions delineating their scope include the Employment Rights Act 1996 and the Carriage of Goods by Sea Act 1971. However, it has been observed that there seems to be a tendency to treat statutory rules as being of international application: Kahn-Freund, *supra* n 13, 250–51; Jackson, *supra* n 9, 61.

[32] Common law mandatory rules are noted to be difficult to identify in practice by PM North and JJ Fawcett, *Cheshire and North's Private International Law* (London, Butterworths, 13th edn, 1999), 582 (hereafter "*Cheshire and North*"); but they are by no means non-existent. The word "loi" was replaced by the word "droit" in the French text of Article 7(1) to make it clear that the provision covered both mandatory legislative provisions and mandatory common law rules: M Giuliano and P Lagarde, "Report on the Convention on the Law Applicable to Contractual Obligations" (1980) OJ C282, 27 (hereafter the "Giuliano–Lagarde Report").

[33] CMV Clarkson and J Hill, *Jaffey on the Conflict of Laws* (London, Butterworths, 2nd edn, 2002), 225 (hereafter "*Jaffey*").

[34] It has been remarked that the language used in the English version of the Convention draws the distinction between these two categories of mandatory rules rather inelegantly: *Jaffey*, *ibid.*

[35] Article 5 has been substantially altered in the proposed Rome I Regulation and is no longer phrased in terms of mandatory rules. See below, section C.3(c)i.

[36] *Infra*, section C.3(c).

[37] Nygh, *supra* n 25, 206.

[38] Zhilsov, *supra* n 13, 88.

[39] Eg, Article 16 of the Rome Convention.

phenomenon whereby public-policy-based decisions undergo a "premature crystallisation" into independent rules and therefore lose the connection with their flexible public policy roots.[40] Numerous writers have articulated the argument that public policy sometimes applies in a positive fashion.[41] That argument, however, is more concerned with the issue whether the public policy of the *lex fori* has led to the positive application of the mandatory rules of the *lex fori*. The more pertinent issue for the purposes of this article is whether or not the positive application of the mandatory rules of the law of a third country occurs under the guise of forum public policy. Two English cases are oft cited in this regard.

Foster v Driscoll [42] involved an English contract to smuggle alcohol into the United States during Prohibition. The illegal performance had not been carried out and the parties had a fall-back plan to land the alcohol lawfully in Canada or some other appropriate place where a third party would thereupon smuggle it into the United States.[43] However, a majority of the Court of Appeal held that the contract was contrary to public policy and void. In *Regazzoni v KC Sethia*,[44] the contract, which was also governed by English law, was for the sale and delivery of jute bags to Genoa. Although it was not mentioned in the contract, both parties were aware that the jute could only be obtained from India and that the buyer intended it for resale in South Africa. The export of jute from India to South Africa was prohibited by Indian law. The House of Lords held that the contract was unenforceable because an English court would not enforce a contract, or award damages for its breach, if its performance involved the doing of an act in a foreign and friendly state which was illegal under the law of that State.

It must be noted that even though the above two cases concerned contracts governed by English law, it is generally accepted that the courts would have had no hesitation in striking them down even if they were governed by a foreign law.[45] Carter suggests that this is so because the principal consideration here is to protect the national or international interests of the United Kingdom; the identity of the *lex causae* is therefore not relevant.[46]

[40] *Supra* n 13, 238–48.

[41] S Lee, "Restitution, Public Policy and the Conflict of Laws" (1998) 20 *University of Queensland Law Journal* 1, 4–6; Mosconi, *supra* n 9, 127; Zhilsov, *supra* n 13, 95; Hartley, *supra* n 9, 350–53; M Forde, "The 'Ordre Public' Exception and Adjudicative Jurisdiction Conventions" (1980) 29 *International and Comparative Law Quarterly* 259, 260.

[42] [1929] 1 KB 470 (hereafter "*Foster*").

[43] Scrutton LJ dissented on this ground.

[44] [1958] AC 301 (hereafter "*Regazzoni*").

[45] *Cheshire and North*, *supra* n 32, 585 (footnote 16); *Jaffey*, *supra* n 33, 250; Hartley, *supra* n 9, 353–54; PB Carter, "Rejection of Foreign Law: Some Private International Law Inhibitions" (1984) 55 *British Yearbook of International Law* 111, 125. *Dicey and Morris* rather inconsistently state that the rule in *Foster* is not a conflicts rule but a rule of English domestic law, albeit one which the authors think applies even if the contract is governed by foreign law: *supra* n 23, 1282 (para 32–238).

[46] *Supra* n 45, 125.

The contentious issue with respect to these two cases is whether the decisions are based on the application of forum public policy or the foreign mandatory rule. It is contentious because the answer determines whether this line of cases survives the Rome Convention. The emphasis in the judgments[47] is very much on the concept of comity and the need to preserve good relations with a friendly foreign state.[48] For example, in *Regazzoni*, Viscount Simonds held that:

> "Just as public policy avoids contracts which offend against our own law, so it will avoid at least some contracts which violate the laws of a foreign State, and it will do so because public policy demands that deference to international comity."[49]

In *Foster v Driscoll*, Lawrence LJ thought that recognition by the Court of Appeal of the contract would:

> "furnish a just cause for complaint by the United States Government against our Government . . . and would be contrary to our obligation of international comity as now understood and recognized, and therefore would offend against our notions of public morality."[50]

This may lead one to surmise that the cases concerned English public policy, specifically application of the second head of public policy that aims to maintain comity between the United Kingdom and other nations. Yet the effect of the decisions is that the United States and Indian mandatory rules were ultimately applied by the English courts.[51] A foreign law that was considered to be "of the utmost importance to that foreign country" was applied to strike down the contract.[52] This then looks like a case where the English courts gave indirect effect to the mandatory rules of a third country under the guise of applying English public policy. If this is correct, the cases do not fall within Article 16 of the Rome Convention as that envisages a negative operation of public policy.[53]

47 See especially, *Regazzoni* [1958] AC 301, 318–19 (Viscount Simonds), 323, 324 (Lord Reid), 327 (Lord Keith), 330 (Lord Somervell); *Foster* [1929] 1 KB 470, 510 (Lawrence LJ), 519, 521 (Sankey LJ). See also Nygh, *supra* n 25, 224–25.

48 For the difficulty in identifying a friendly foreign state and having to take sides between two such states, see FA Mann, "Illegality and the Conflict of Laws" (1958) 21 *Modern Law Review* 130, 133; FMB Reynolds, "The Enforcement of Contracts Involving Corruption or Illegality in Other Countries" [1997] *Singapore Journal of Legal Studies* 371, 379, 387–88.

49 [1958] AC 301, 319.

50 [1929] 1 KB 470, 510.

51 Mann, *supra* n 48, 133–34; J Harris, "Contractual Freedom in the Conflict of Laws" (2000) 20 *Oxford Journal of Legal Studies* 247, 262 (footnote 78).

52 *Cheshire and North*, *supra* n 32, 586.

53 *Cheshire and North*, *supra* n 32, 585; Hartley, *supra* n 9, 403; J Hill, *International Commercial Disputes* (Oxford, Hart Publishing, 3rd edn, 2005), 525 (para 14.4.38). The cases could come under Article 16 only if it is possible to construe the phrase "rule of law" as meaning "the notional, unexpressed rule of the applicable law, according to which the contract is *not* illegal or invalid": P Kaye, *The New Private International Law of Contract of the European Community: Implementation of the EEC's Contractual Obligations Convention in England and Wales under the Contracts (Applicable Law) Act 1990* (Aldershot, Dartmouth Publishing, 1993), 347 (emphasis in original). This is obviously strained reasoning which is better not pursued.

Instead, it is thought that Article 7(1), which permits a court to apply the international mandatory rules of a third country, encapsulates the situation that arose in those cases.[54] Article 7(1), however, is not part of the law of the United Kingdom and therefore this line of cases must be considered not to survive the Rome Convention.[55]

The debate as to whether *Foster* and *Regazzoni* continue to be applicable under the Rome Convention may shortly become redundant. In the proposed Rome I Regulation,[56] Article 7(1) is transposed as the new Article 8(3). It may be the case that Article 8(3) is discarded or amended in the final version. However, if Article 8(3) survives, *Foster* and *Regazzoni* will stand under the future Rome I Regulation as English courts will acquire the discretion to apply a third country's mandatory rules. The question as to whether this would be something to be welcomed or not is the object of the next section.

C. Law of a Third Country

This section will commence with a principled examination of whether the law of a third country should be given effect in an international contract. Next, the methods by which a third country's laws can be given effect will be investigated. This will be followed by an analysis of instances where a third country's laws are given effect in case law, international conventions and national laws, with a particular focus on the Rome Convention.

1. Considerations of Principle

Why should the forum bother giving effect to another country's public policy and mandatory rules if that country is not the *lex causae*? Two reasons may be put forward: the interest of the third country in having its law applied and comity.

(a) The Interest of the Third Country in Having its Law Applied

The third country may have an interest in having its public policy or mandatory rules applied in a case heard in another forum. As Kaye argues:

> "International contracts cannot be isolated within a conceptual vacuum . . . the fact that they have effects in other countries, which may be vitally important for the parties or those countries themselves . . . cannot simply be ignored"[57]

[54] Hartley, *supra* n 9, 403; *Cheshire and North*, *supra* n 32, 586.

[55] Cf P Stone, *Conflict of Laws* (London, Longman, 1995), 258; D Lasok and PA Stone, *Conflict of Laws in the European Community* (Abingdon, Professional Books, 1987), 373. The argument that the cases survive the Rome Convention via Article 7(2) is considered *infra*, text to nn 222–24.

[56] COM (2005) 650 final.

[57] *Supra* n 53, 256. Vischer, *supra* n 12, 175, would add the proviso that a foreign state's interest should only be taken into account where it is congruent with the interests of the forum.

The recognition of this third state's interest by the forum is based on the idea of governmental interest analysis. This stems primarily from Currie's thesis, the gist of which is that:

> "The application of foreign law is justified when that law expresses a policy of the foreign state, when the connections of the case with the foreign state are such as to give it a legitimate interest in having its policy applied, and when there is no conflicting interest of the forum state."[58]

Interest analysis has its fair share of critics. It has been argued that construing a legislature's intent is a futile process as the extent of the intended territorial reach of a rule will often not be articulated or even considered.[59] This applies *a fortiori* when a court is trying to discern a foreign state's intentions. However, the court's task may not be as difficult as it may seem as it will not be considering the foreign rule without some assistance. As Jackson notes, it will be for the party alleging application of a particular foreign mandatory rule to persuade the court that the rule should be applied in the situation before it.[60] Another criticism is that governmental interest is only relevant to public law, not private law matters.[61] This has been refuted by Vischer who points out that governmental interests would include safeguarding the public interest as well as balancing private interests.[62] Furthermore, critics argue that the doctrine focuses on a state's interest at the expense of parties' interests.[63] However, this last objection falters in relation to a mandatory rule because as Hartley points out, "mandatory rules are the fruit of specific policies, and those policies are regarded as being of such importance that they override the interests of the parties."[64]

The influence of Currie's ideas in the area of choice of law for contract can be seen in section 187(2)(b) of the *Restatement (2nd) of Conflict of Laws* and Article 19(1) of the Swiss Private International Law Statute 1987.[65] Article 7(1) of the Rome Convention also has its roots in interest analysis[66] and this underlying basis is made more overt in Article 8(3) of the proposed Rome I Regulation. A court,

58 B Currie, *Selected Essays on the Conflict of Laws* (Durham, NC, Duke University Press, 1963), 48.

59 Hartley, *supra* n 9, 364; A Bonomi, "Mandatory Rules in Private International Law: The quest for uniformity of decisions in a global environment" in P Šarčević and P Volken, *Yearbook of Private International Law* (Vol. I) (The Hague, Kluwer Law International, 1999), 231 (footnote 54).

60 *Supra* n 9, 75.

61 K Zweigert, "Some Reflections on the Sociological Dimensions of Private International Law or What is Justice in Conflict of Laws?" (1973) 44 *University of Colorado Law Review* 283, 288; A Ehrenzweig, *A Treatise on Conflict of Laws* (St Paul, West, 1962), 63. Both cited in Vischer, *supra* n 9, 54–55.

62 Vischer, *supra* n 9, 55.

63 *Ibid.*

64 Hartley, *supra* n 9, 364.

65 See *infra*, section C.3(b).

66 P Lagarde, "The European Convention on the Law Applicable to Contractual Obligations: An Apologia" (1981) 22 *Virginia Journal of International Law* 91, 103; CGJ Morse, "The EEC Convention on the Law Applicable to Contractual Obligations" (1982) 2 *Yearbook of European Law* 107, 146; Stone, *supra* n 55, 261.

in considering whether to give effect to the third State's mandatory rules, "shall have regard to their nature and purpose . . . and to the consequences of their application or non-application for the objective pursued by the relevant mandatory rules and for the parties."[67]

(b) Comity

It has been seen above that there is a recognition in some quarters that the third country has a legitimate interest in having its laws applied. The question then is: why should the forum defer to such interests? The oft-cited reason is comity. This is an elusive concept but has at its heart application of foreign law and recognition of foreign acts[68] owing to "considerations of justice and of the mutual convenience of states."[69] Comity has been criticised but arguably the criticisms[70] have more to do with the imprecise and inconsistent use of the word rather than the doctrine of comity itself. However, Wolff argues that:

> "The doctrine is erroneous because it is based on the idea that any state has an interest in the application of its law by the courts of other states. Suppose that the true proper law of a contract concluded in Italy between two Frenchmen is Italian law, but that the English court which entertains an action arising out of that contract wrongly holds that French law applies and therefore dismisses the action – then it is only the plaintiff who suffers – the Italian state is indifferent."[71]

That may be so when one is speaking of the situation above where a faulty application of English choice of law rules has led to the non-application of Italian domestic law, but it is submitted that if one were considering Italian international mandatory rules, that would be a different matter. The mere fact that Italy has chosen to make a rule of theirs applicable in international situations irrespective of the governing law of the contract surely indicates that it is a rule which is of some importance to it such that it would hardly be indifferent should that particular international mandatory rule be ignored by the English court.

As Drobnig observes, "states should mutually pay regard for each other's interests".[72] Several reasons, based on or derived from the concept of comity,

[67] Morse, *supra* n 66, 146, observes in relation to Article 7(1) that: "It is paradoxical that a method of analysis so often criticised by Europeans as being subjective [footnote reference omitted] should find its way into a European Convention on choice of law in contracts."

[68] M Wolff, *Private International Law* (Oxford, Clarendon Press, 2nd edn, 1950), 14–15. *Cheshire and North* point out that if "comity" were to be given its normal meaning, ie "acts of courtesy", this would not explain why English courts apply enemy law in times of war: *supra* n 32, 5. Wolff points out that Germany did not forbid application of English law during the war as well: 15.

[69] GC Cheshire, *Private International Law* (Oxford, Clarendon Press, 1935), 6; quoted by Collins, *supra* n 21, 104.

[70] *Cheshire and North*, *supra* n 32, 5; Wolff, *supra* n 68, 14–15;

[71] Wolff, *supra* n 68, 15.

[72] O Lando, B von Hoffman and K Siehr (eds), *European Private International Law of Obligations* (Tübingen, Mohr, 1975), 83; cited by FA Mann, "Contracts: Effects of Mandatory Rules" in K Lipstein (ed), *Harmonisation of Private International Law by the EEC* (London, Institute of Advanced Legal Studies/University of London, 1978), 35.

may be advanced in relation to this position. First, there is the motivation to preserve relations with friendly foreign states.[73] This reason has been criticised on the ground that it is sovereigns and not courts who have the task of maintaining foreign relations[74] and the idea of the separation of powers in this regard appears to be strictly enforced in continental Europe.[75]

Secondly, the spirit of internationalism comes into play in that there is a need to foster international co-operation. As has been recognised:

> "no nation can expect its laws to reach further than its jurisdiction to prescribe, adjudicate, and enforce. Every nation must often rely on other countries to help it achieve its regulatory expectations. Thus, comity compels national courts to act at all times to increase the international legal ties that advance the rule of law with and among nations."[76]

This is obviously an important consideration in today's age where States are more socially and economically interdependent than ever before. It applies *a fortiori* if the rationale underlying the relevant foreign mandatory rule or public policy is one which is shared by the forum[77] or could be said to be in the "common interest of the international community of States."[78]

Thirdly, there could be an element of self-interest in giving deference to another State's mandatory laws and public policy. In another context, Kramer has observed that enforcing foreign law is better than always enforcing forum law because "it invites reciprocal action that advances forum policies in cases brought elsewhere."[79] Thus, the willingness of a court to give effect to a third State's mandatory rules and public policy in situations where it is not obliged to do so[80] might encourage similar reciprocal action by foreign courts.[81]

Fourthly, giving effect to a third state's laws would ameliorate the problem of forum shopping and help lead towards uniformity of decisions. Although harmonisation of choice of law and jurisdictional rules work in tandem to achieve the twin objects of deterring forum shopping and achieving uniformity of decisions, loopholes remain. For example, under the Brussels I Regulation on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial

73 *Foster* [1929] 1 KB 470; *Regazzoni* [1958] AC 301.
74 *Cheshire and North*, *supra* n 32, 5.
75 Bonomi, *supra* n 59, 238.
76 *Laker Airways Ltd v Sabena Belgian Airlines* 731 F 2d 909 at 937 (DC Cir 1984), *per* Judge Wilkey.
77 Bonomi, *supra* n 59, 238; Hartley, *supra* n 9, 365.
78 Bonomi, *supra* n 59, 238.
79 L Kramer, "Return to Renvoi" (1991) 66 *New York Law Review* 979, 1016; quoted by Bonomi, *supra* n 59, 238.
80 Because the third State is not the *lex causae.*
81 This is not, however, to say that reciprocity should be a precondition of the invocation of the doctrine of comity. This would be a narrow-minded line of thinking which raises the danger of wealthier and stronger nations imposing their will upon other nations. It would fall foul of what Mann condemns as "the supremacy of the most ambitious and most political of States . . . the submission of the moderate to the extreme": *supra* n 72, 35.

Matters,[82] Article 27 forbids the court of a Member State from proceeding with a case involving the same parties and same cause of action which has already been brought in the court of another Member State. Speed is imperative and the "first come, first served" approach means that the outcome of the case could depend on which party is quicker to bring his claim in his favoured forum. Bonomi argues that "In this context, it is not reasonable – and it can be very unjust – to ignore the mandatory rules of another contracting State where, under the same circumstances, the proceedings could have taken place."[83] This observation applies as well to the fact that more than one fora may be available under the Brussels I Regulation.[84] In addition, as matters now stand, inconsistency exists within the Member States of the European Community due to the reservation entered against Article 7(1) of the Rome Convention by the United Kingdom,[85] Germany, Luxembourg, Portugal and Ireland. Of course, it could be argued that since, first, Article 7(1) gives the court a discretion and does not oblige the court to apply the third State's mandatory rules; and secondly, the circumstances under which a third State's laws could be said to be relevant under this provision are not clearly delineated, uniformity does not seem to be a good possibility even if all Member States were to enact Article 7(1). However, the potential for uniformity would be higher if it were enacted across the board. This is because the European Court of Justice would be able to give guidance as to how Article 7(1) should operate and thus a third country's mandatory rules would be taken into account in a consistent manner in all Member States. Whereas as things now stand, countries that have not enacted Article 7(1) are left to their own devices as to when and in what manner a third country's laws would be relevant. This *ad hoc* approach towards the consideration of foreign interests results in unpredictability and uncertainty.[86]

Fifthly, in view of the fact that most, if not all, legal systems recognise and enforce foreign judgments, "it does not seem sensible to exclude the direct application of [foreign mandatory] rules, when one considers that they could have effect indirectly in the forum through the recognition of a decision handed down in the foreign country."[87] This point is bolstered by the fact that the European regime on recognition and enforcement of foreign judgments is becoming increasingly automatic. A judgment given in a Member State is to be recognised in another Member State without any special procedure[88] and furthermore, a

[82] Hereafter the Brussels I Regulation.

[83] *Supra* n 59, 240.

[84] This is one of the justifications put forward by the European Commission for Article 8(3) of the draft Rome I Regulation; see COM (2005) 650 final, 9.

[85] Section 2(2) of the Contracts (Applicable Law) Act 1990.

[86] "Note – Article 7(1) of the European Contracts Convention: Codifying the Practice of Applying Foreign Mandatory Rules" (2001) 114 *Harvard Law Review* 2462, 2474–75.

[87] Bonomi, *supra* n 59, 240.

[88] Article 33 of the Brussels I Regulation. See also Regulation (EC) No 805/2004 of the European Parliament and of the Council of 21 April 2004 creating a European Enforcement Order for uncontested claims (2004) OJ L143/15.

judgment cannot be reviewed as to its substance.[89] This means that indirect application of a third country's laws is a customary occurrence under the recognition and enforcement provisions.[90] This is in addition to the indirect effect that is given to the law of a third country via the governing law of the contract or the *lex fori*, an issue that will be looked at below.[91]

Sixthly, there is perhaps the simplest and strongest reason of all – to do justice between the parties. This is the case where a particular contracted-for act has subsequently become illegal according to the law of the place of performance; in this situation, would the court enforce the contract and thereby expose the party who has to carry out the illegal performance to sanctions in the place of performance?[92] Surely justice and legitimate party expectations in this scenario would be that the contract would not be enforced.[93]

Thus, it can be seen from the above that the concept of comity and derivations from this concept reveal several strong reasons why a court should give effect to a third country's public policy and mandatory rules.

2. Modes of Application of the Third Country's Laws: Indirect and Direct Application

Having established above that there is a case for arguing that a third state's public policy and mandatory rules should be applied by a court as a recognition of the third country's legitimate interest in a particular issue and on grounds of comity,[94] the next issue concerns the mode in which the third country's law should be given effect. One could give effect to the third country's laws indirectly or directly. The availability of two modes of applying a third country's laws is expressly recognised in Germany which has developed the concepts of *Schuldstatuttheorie* and *Sonderanknüpfungstheorie* respectively.[95]

[89] Article 45(2) of the Brussels I Regulation.

[90] Admittedly there is a conceptual difference between having to recognise and enforce a decision handed down by another court and having to decide which laws are applicable as the court first seised of a case. However, at the end of the day, a third country's laws are ultimately given effect by the forum in the former situation.

[91] Section C.2(a).

[92] The case in point is *Ralli Bros v Compania Naviera Sota y Aznar* [1920] 2 KB 287. However, *Ralli Bros* has been interpreted as a case concerning the application of a rule of English domestic law of contract as the proper law of the contract was English law. See *infra*, section D.1.

[93] See s 2.615(a) of the Uniform Commercial Code which states that: "Delay in delivery or non-delivery by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by . . . compliance in good faith with any applicable foreign or domestic governmental regulation or order."

[94] Cf J Harris, "Does Choice of Law Make Any Sense?" *Current Legal Problems* (Oxford University Press, 2004), 348.

[95] Voser, *supra* n 4, 323–24; Vischer, *supra* n 9, 168.

(a) Indirect Application

The German concept of *Schuldstatuttheorie* describes the traditional method under which the third country's laws are taken into account as a factor within the application of the *lex causae*. Voser claims that this indirect method has "found application in all legal systems".[96] In *Kulturgüterfall*,[97] illegally exported Nigerian cultural goods were damaged during their transport from Nigeria to Hamburg. The insurance contract was governed by German law. The German *Bundesgerichtshof* applied the concept of *Schuldstatuttheorie* and held that the evasion of the Nigerian law was an immoral act under section 138 of the *Bürgerliches Gesetzbuch* (German Civil Code).[98] Thus, Nigerian law was not applied directly, but only through the aegis of the governing law of the contract, ie German law.[99]

In England, the indirect mode of application involves not just the consideration of the third country's laws as a factor by the governing law of the contract[100] but also by the *lex fori*. In *Regazzoni v KC Sethia*,[101] it was English public policy, acting as forum public policy, which took note of the fact that the contract involved performance which would have breached an Indian mandatory rule. The Indian mandatory rule was not applied *per se*;[102] the contract was unenforceable because it was against English public policy to enforce contracts that involved the performance of an illegal act according to the laws of a friendly foreign state.[103] This is an example of a third country's mandatory rule being taken into account to the extent that it is relevant under the *lex fori*. Swiss courts also appear to allow indirect application *via* the *lex fori*; they construe illegality by a third state's law as contravening Swiss notions of morality.[104]

However, critics of this indirect mode of application have pointed out that at the end of the day it is the third country's laws which are given effect. In relation to the *Kulturgüterfall*,[105] Vischer observes that the question of immorality under German law only arose because of the Nigerian prohibition. "What the German

96 Voser, *supra* n 4, 323.

97 BGH, 22 June 1972; BGHZ 59, 82; discussed by Vischer, *supra* n 9, 170.

98 Cf Mayer who argues that it cannot be immoral to fail to respect a law which is inapplicable: cited by D Hochistrasser, "Choice of Law and 'Foreign' Mandatory Rules in International Arbitration" (1994) 57 *Journal of International Arbitration* 57, 71.

99 The interest of the third country must be considered legitimate by German standards: Vischer, *supra* n 9, 171. See (2001) 114 *Harvard Law Review* 2462, 2471 for more examples of German case law which took account of a third country's mandatory rules.

100 *Ralli Bros v Compania Naviera Sota y Aznar* [1920] 2 KB 287.

101 [1958] AC 301; facts *supra* text to n 44.

102 The same interpretation is adopted by Nygh, *supra* n 25, 224–25. Cf *Cheshire and North*, *supra* n 32, 586; Harris, *supra* n 51, 262 (footnote 78).

103 See [1958] AC 301, 324, *per* Lord Reid: "this case does not, in my view, involve the enforcement of Indian law in England. In fact, no breach of Indian law in the execution of this contract was ever committed or attempted because the contract came to an end by its repudiation by the respondents within a few days after it was made".

104 Hochistrasser, *supra* n 98, 72.

105 BGH, 22 June 1972; BGHZ 59, 82.

courts did, in fact, was to implement the foreign legislative policy when it was regarded as justified under German law."[106] The same point could also be made in relation to *Regazzoni*.[107] Despite the emphasis in the judgments on the basis of the decision being application of forum public policy, the end result was that the Indian mandatory rule was given effect.

Given that it appears that the same result ensues whether one directly applies the third state's laws or indirectly applies it within the confines of the governing law of the contract or public policy of the forum, is it necessary to examine which mode represents the best method? The answer is "yes". First, the same result may not always be achieved under both modes. As Voser points out, the opportunity for indirect application depends on whether or not there are "possibilities of consideration existing within the applicable law"[108] such as impossibility, immorality or illegality.[109] Secondly, the broader reason of having legal principles clearly articulated can only be of benefit to the overall running of a legal system. Thus, the alternative mode of direct application of the third country's laws will next be examined in order to gauge which of the two modes is preferable.

(b) Direct application

The method of direct application of a third country's laws is self-explanatory. It is thought that its origin lies with the German concept of *Sonderanknüpfungstheorie*[110] or "Special Connection" approach.[111] This involves the direct application of foreign public laws which affect private legal relationships, usually those involving export control and import or export restrictions, upon examination of their scope and purpose. As such, it has close ties with Currie's governmental interest analysis whereby rules are functionally analysed.

As has been seen above, if it is the third country's laws which are ultimately given effect in cases like *Kulturgüterfall*,[112] *Regazzoni v KC Sethia*[113] and similar cases, recognition of direct applicability could represent a more honest way forward. This is the position of Mayer, who argues that the authority of the third state's

[106] Vischer, *supra* n 12, 171, citing C von Bar, *Internationales Privatrecht*, Vol. 1, 'Allgemeine Lehren' (Munich, C H Beck, 1987), n 265. Cf K Siehr, "International Art Trade and the Law" (1993-VI) 243 *Recueil des Cours* 9, 52–53, 190–91; cited by Nygh, *supra* n 25, 225.

[107] [1958] AC 301.

[108] One may add here, or *lex fori*.

[109] *Supra* n 4, 343.

[110] Translated into "Sonderstatut Theory" in English academic writings: Nordic Group for Private International Law, *Proposal for Amendments to the Convention on the Law Applicable to Contractual Obligations*, 46 (footnote 120); document accessible online at: http://www.europa.eu.int/comm/justice_home/news/consulting_public/rome_i/doc/nordic_group_private_international_law_en.pdf (as on 23 February 2006); R Plender, *The European Contracts Convention: The Rome Convention on Choice of Law for Contracts* (London, Sweet & Maxwell, 2nd edn, 2001), 184 (para 9–02); Mann, *supra* n 72, 32.

[111] *Dicey and Morris*, *supra* n 23, 1245 (para 32–138).

[112] BGH, 22 June 1972; BGHZ 59, 82.

[113] [1958] AC 301.

mandatory rule must be explicitly acknowledged if it is used to annul a contract; it is not sufficient to take it into account indirectly.[114]

A question arises: must the third country be the country of closest connection or would it suffice if it has a close or significant connection with the contract before its laws can be taken into account? It is submitted that the latter suffices. Of course, the public policy and mandatory rules of the law of closest connection would be a prime candidate for being taken into account. However, other third countries' laws which may not be the law of closest connection may have just as strong an interest as, or an even stronger interest than, the objective governing law. An example would be if the contract involves performance of an act in a third country which is illegal according to that country's laws, this third country not being the objective governing law.[115] Objections that the criterion of "close connection" is too vague can be countered because identification of the law of closest connection as the governing law of the contract in the absence of party choice is also prey to vagueness. Under the common law weighing of factors method in order to arrive at the objective proper law of the contract, different judges may arrive at different conclusions on the same facts. Under the Rome Convention, the presumptions set out in Article 4(2) would not be a useful aid if the judges prefer to fall back upon Article 4(5).[116] Although there is *dictum* to the effect that English courts should apply the presumption set out in Article 4(2) "except where evidence *clearly* shows that the contract is more closely connected with another country",[117] Hill[118] demonstrates that English courts have preferred to rely on Article 4(5) even where it is not well established that the *dictum* is fulfilled: "the courts have disregarded the presumption on little more than a balance of factors."[119] In an attempt to enhance certainty, the proposed Rome I Regulation replaces the series of presumptions with fixed rules; the draft Article 4(1) sets out choice of law rules in favour of the law of the habitual residence of

[114] P Mayer, *Mandatory Rules of Law in International Arbitration* in Arbitration International (1996); cited by Hochistrasser, *supra* n 98, 71.

[115] The role of the *lex loci solutionis* is examined in greater detail below; see *infra* section D.

[116] The English courts favour a more liberal application of Article 4(5) in comparison with the Scottish and Dutch courts. See *Bank of Baroda v Vysya Bank* [1994] 2 Lloyd's Rep 87; *Definitely Maybe (Touring) Ltd v Marek Lieberberg Konzertagentur GmbH* [2001] 4 All ER 283; *Samcrete Egypt Engineers and Contractors SAE v Land Rover Exports Ltd* [2001] EWCA Civ 2019, [2002] CLC 533; *Kenburn Waste Management Ltd v Bergmann* [2002] EWCA Civ 98, [2002] CLC 644. Cf *Caledonia Subsea Ltd v Micoperi Srl (First Division, Inner House, Court of Session)* 2003 SC 70; *Société Nouvelle des Papeteries de l'Aa v Machinefabriek BOA*, 25 September, NJ (1992) No 750, RvdW (1992) No 207 (Dutch Supreme Court). See also J Hill, "Choice of Law in Contract under the Rome Convention: The Approach of the UK Courts" (2004) 53 *International and Comparative Law Quarterly* 325, 334–46; S Atrill, "Choice of Law in Contract: The Missing Pieces of the Article 4 Jigsaw?" (2004) 53 *International and Comparative Law Quarterly* 549.

[117] *Ennstone Building Prodicts Ltd v Stanger Ltd* [2002] 1 WLR 3059, 3070 (para 41), *per* Keene LJ (emphasis added). See also *Samcrete Egypt Engineers and Contractors SAE v Land Rover Exports Ltd* [2001] EWCA Civ 2019, [2002] CLC 533, 545 (para 45), *per* Potter LJ.

[118] Hill, *supra* n 116, 341–44.

[119] *Ibid*, 341.

the characteristic performer of the contract for different categories of contracts. However, there is inevitably a residuary provision for the law of closest connection, and all the problems that that entails, for situations where the characteristic performer cannot be identified.[120] As Jackson argues: "Uncertainty as an objection would have greater force if the principles now applied were certain. They are not."[121] Thus, it is suggested that a close connection suffices to trigger operation of a third country's laws.

However, the objections to direct applicability have to be examined. Application of the public policy and mandatory rules of third countries to a contract contrary to the parties' wishes would undermine party autonomy and expectations.[122] In addition, a serious problem created by taking into account a third country's laws is uncertainty. It was in fact primarily this factor which led the United Kingdom and other countries[123] to enter a reservation against Article 7(1).[124] A persuasive argument on uncertainty can be made. Parties would not be able to identify which law or laws other than the governing law or the *lex fori*[125] would apply to their contract and thus would not have any clear indication of which third country's laws they would need to satisfy. If the third country is only required to have a close or significant connection with the contract, how would one define this required connection? If the third country is restricted to the country of closest connection, uncertainty exists because, as alluded to above, it is difficult to pinpoint the objective governing law in many cases.

Nevertheless, the disadvantages of applying a third country's laws could be overstated. Party autonomy is not all conquering; parties are unable to evade the public policy and mandatory rules of the forum[126] or of the applicable law in the absence of choice in the case of consumers and employees.[127] These are instances where policy grounds based respectively on forum sovereignty[128] and weaker party protection outweigh party autonomy. Arguably, preservation of a third country's interest and comity provide a similarly strong basis for the detraction from party autonomy and party expectations.

[120] Article 4(2).

[121] Jackson, *supra* n 9, 75. Of course, this comment has no force in cases where the parties have chosen the applicable law.

[122] Authors who disapprove of Article 7(1) of the Rome Convention include Mann, *supra* n 72; Morse, *supra* n 66, 147; A Philip, "Mandatory Rules, Public Law (Political Rules) and Choice of Law in the EEC Convention on the Law Applicable to Contractual Obligations" in *Contract Conflicts*, 100 (para 40); PM North, "The EEC Convention on the Law Applicable to Contractual Obligations (1980): Its History and Main Features" in *Contract Conflicts*, 19–20.

[123] Germany, Luxembourg, Portugal and Ireland.

[124] Hansard HL 12 Dec 1989 Vol 513, col 1258; Giuliano–Lagarde Report, *supra* n 32, 28.

[125] In terms of the international mandatory rules and public policy of the *lex fori*.

[126] Articles 7(2) and 16 of the Rome Convention.

[127] Articles 5 and 6 of the Rome Convention.

[128] The forum is entitled to refuse to act in contravention to its principles, and it is not unreasonable to say to the parties that if they choose to litigate in a particular forum, they must take the law (ie, the forum's private international law) as they find it.

The argument on uncertainty can be countered as follows. First, one must bear in mind that there is a body of case law whereby an English court has taken into account a third country's mandatory laws via operation of English public policy or application of English law as the governing law of the contract.[129] Indirect application has been sanctioned under English common law; it is not that big a leap towards direct application as there exists a framework upon which one can build. The common law cases can be examined to discover principles that could guide courts as to how direct applicability should operate.[130]

Secondly, if direct applicability were to be available to the laws of any third country with a "close connection" with the contract, one should not worry that unacceptable uncertainty will ensue in that there would be "an uncontrolled influx"[131] of third-country laws claiming application. Everything depends on the particular facts of the case of course but in an international contract, the possible third-country laws that may at first glance be thought to have a claim of being of close connection to a contract such that it has a legitimate interest in the application of its laws are few, and when considered further, can be narrowed down drastically. The potential laws that spring to mind are the *lex loci contractus*, the law of the parties' domicile and the *lex loci solutionis*.

The first option can be set aside quickly. The place where the contract is made could be entirely fortuitous and furthermore, applicability of the *lex loci contractus* is based on the vested rights theory, which has now been largely discredited.[132]

The law of the parties' domicile may also be dismissed.[133] The relevance of the law of the debtor's residence or main place of business has been rejected under the common law. In *Kleinwort v Ungarische*,[134] the contract, governed by English law, provided for payment in pounds sterling in London by the Hungarian defendants. Hungary subsequently passed a decree making it illegal for any Hungarian resident to make payment in foreign currency anywhere to anybody unless permission was obtained from the Hungarian National Bank.[135] The defendants argued that, according to the principle set out in *Ralli Bros v Compania Naviera Sota y Aznar*,[136] the illegality meant that they were no longer obliged to carry out their part of the bargain as they could not do so without

[129] *Foster v Driscoll* [1929] 1 KB 470; *Regazzoni v KC Sethia* [1958] AC 301.
[130] See *infra* section D.
[131] Vischer, *supra* n 9, 169.
[132] See *Cheshire and North*, *supra* n 32, 20–22; *Babcock v Jackson* [1963] 2 Lloyd's Rep 286, 287, *per* Fuld J.
[133] Although the Giuliano–Lagarde Report cites the country where one party is resident or has his main place of business as having a "genuine connection" for the purposes of Article 7(1): *supra* n 32, 27. If both parties were domiciled in the same country, a stronger case may possibly be advanced for the application of the international mandatory rules of the law of their common domicile.
[134] [1939] 2 KB 678.
[135] It was inferred that the defendants had applied for and were refused such permission.
[136] [1920] 2 KB 287; discussed *infra*, section D.1.

breaching Hungarian law. The Court of Appeal held that the present situation was different from *Ralli* in that the place of performance of the contract was England, not Hungary: "the contract is not concerned with the steps which the debtors may have to take to put themselves in a position to pay. It is concerned only with the payment itself, which is to be made in this country."[137] The same applies when the debtor is pleading *existing* illegality according to the law of his domicile.[138]

Hence, there remains only the *lex loci solutionis*. The performance obligation forms the heart of the contract and thus it has long been recognised that the *lex loci solutionis* has the necessary "close connection" with a contract such that it has a legitimate interest in having its laws applied.[139] This is established under the common law by cases such as *Foster v Driscoll* and *Regazzoni v KC Sethia*.[140] In fact, attempts to extend the principle in these two cases to illegal acts in places other than the place of performance have been rejected.[141] In *Mirza Salman Ispahani v Bank Melli Iran*,[142] Walker LJ affirmed that "the carrying out of prohibited acts *within* the territory in question is an essential and necessary element"[143] of the principle in *Foster* and *Regazzoni* as "international comity is naturally much readier to accept that a country's laws ought to be obeyed within its own territory, than to recognise them as having exorbitant effect."[144] There is therefore a body of case law concerning the relevance of the *lex loci solutionis* that could be drawn upon to derive principles which will guide the courts and inform party expectations.[145]

One last general point must be made. If direct application of a third country's public policy and mandatory rules were to be sanctioned, this would be so only by virtue of a conflicts rule of the forum; the third country's laws are not applicable of their own accord.[146] To put it in another way, the forum retains ultimate control over the whole process.[147] The interest of the third country must always satisfy the forum's standards of legitimacy. Furthermore, there is the additional safeguard of forum public policy. If the result of the application of the third country's laws is offensive to the forum, it will be denied efficacy.

[137] *Ibid*, at 700, *per* Atkinson J.
[138] *Toprak v Finagrain* [1979] 2 Lloyd's Rep 98.
[139] For specific issues pertaining to electronic performance, see J Fawcett, J Harris, M Bridge, *International Sale of Goods in the Conflict of Laws* (Oxford University Press, 2005), ch 21, s III.
[140] Albeit the cases establish indirect application via the operation of forum public policy. See *supra*, section B.3.
[141] *Toprak v Finagrain* [1979] 2 Lloyd's Rep 98.
[142] [1998] Lloyd's Rep Bank 133.
[143] Emphasis in original.
[144] Cf Reynolds, *supra* n 48, 376, 393.
[145] This is the object of section D.
[146] O Lando, "Chapter 24: Contracts" in K Lipstein (chief ed), *International Encyclopedia of Comparative Law*, Vol. 3 (The Hague, Tübingen, 1976), 40 (para 75).
[147] Vischer, *supra* n 9, 169. This is the approach taken in Europe: Article 7(1) of the Rome Convention; Article 19 of the Swiss Private International Law Statute 1987.

All in all, the arguments against the direct applicability of a third country's public policy and mandatory rules can be surmounted. Of the two modes of application, it is submitted that direct applicability represents the way forward. The courts would be able to give proper consideration to a third country's laws' scope and purpose instead of hiding behind forum public policy or the governing law of the contract and having to depend on whether there are possibilities of consideration existing within those two laws. Indeed, if Article 8(3) of the draft Rome I Regulation survives into the final draft, English courts will have the discretion directly to apply a third country's mandatory rules.[148] If this turns out to be the case, this development should be welcomed.

(c) Summary on Mode of Applicability

The following points may be made:

1. An English court should have the discretion to apply the laws of a third country if there is a sufficiently "close connection" between the contract and the third country such that the third country has a legitimate interest in having its law applied. The law of the third country need not necessarily be the law of closest connection to the contract.
2. This third country's laws should be directly applied by the forum.
3. The third country that would most obviously be considered to have a legitimate interest in having its law applied by the forum is the place of performance. The principles that can be derived from the body of common law cases in which the interests of the *lex loci solutionis* have been considered should be used as guidelines as to how a third country's laws that have the necessary close connection should be given effect.

3. Provisions that Take into Account a Third Country's Laws

Having made the theoretical case for the direct application of a third country's laws, instances where direct application is provided for will now be examined. There will be a general survey of the case law in other jurisdictions, international conventions and national laws. The relevant provisions of the Rome Convention will be analysed in detail.

(a) Case Law

The first judicial embrace of the applicability of a third country's laws occurred in *Van Nievelt, Goudriaan and Co's Stoomvaartmij NV v NV Hollandsche Assurantie Societeit and Others*,[149] commonly known as the *ALNATI* case. The contract concerned the

[148] See *infra* section C.3(c)iv.

[149] HR 13 May 1966, Nederlandse Jurisprudentie 1967 no. 3, annotated by LJ Hijmans van den Bergh; (1967) 56 *Revue Critique de droit international privé* 522.

carriage of goods from Belgium to Brazil between Dutch parties. The bill of lading was delivered in Belgium. There was a choice of law clause for Dutch law. A mandatory rule of Belgian law stipulated that the 1924 Hague Rules applied whenever goods were loaded in a Belgian port or the bills of lading were delivered in Belgium. Dutch law had no such provision. The question was whether the Dutch courts should take account of this Belgian mandatory rule to invalidate an exclusion clause limiting the ship-owner's liability with respect to damage to the goods. The Hoge Raad considered whether the Belgian mandatory rule should be applied. It concluded that the connection to Belgium was not of such a nature as to warrant the application of Belgian mandatory rules. The importance of the decision, however, is the view of the Hoge Raad that:

> "it may be that, for a foreign State, the observance of certain of its rules, even outside its own territory, is of such importance that the courts must take account of them, and hence apply them in preference to the law of another State which may have been chosen by the parties to govern their contract."[150]

Similarly, in *CEP v Sensor Nederland*,[151] an embargo order by the United States prohibited the export of equipment for the trans-Siberian pipeline by US companies to the Soviet Union. The embargo applied to the supplier of the equipment, a Dutch subsidiary of a US company. The applicable law of the contract was Dutch law. The Dutch court held that in certain circumstances, though the instant case was not one of them, Dutch courts had to apply the mandatory provisions of a foreign country even where the applicable law is Dutch law, if the contract had a sufficient connection with the country concerned.

It is obvious that the fact that the foreign rule may be applicable on its own terms to the contract in question is not sufficient to render it applicable.[152] In both *ALNATI* and *Sensor*, the respective Belgian rule and US embargo order were applicable on their own terms to the contracts in question. If a foreign rule is given effect to, it is in all cases because a conflict rule of the forum renders it so applicable. In other words, the forum decides whether the connection between the contract and the third country is sufficiently close to warrant application of the third country's mandatory rules.

(b) International Conventions and National Laws

Clear support for the proposition that the law of a third country should be given effect can be found in conventions and national laws. The differences lie in the degree of connection required between the contract and the third country.

Section 187(2)(b) of the *Restatement (Second) of Conflict of Laws* states that the law chosen by the parties will not be applied if:

[150] Quoted in the Giuliano–Lagarde Report, *supra* n 32, 26.
[151] Pres Rb Den Haag, 17 September 1982, (1983) 23 *International Legal Matters* 66.

"application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which . . . would be the state of the applicable law in the absence of an effective choice of law by the parties."

The commentary explains that "fundamental policy" is something that is not as crucial as public policy but more important than the considerations that would make a rule mandatory only. The law of the third country here is the applicable law in the absence of choice in relation to the issue at hand. This is described as the law of the state which has the "most significant relationship" to the transaction and the parties.[153] The underlying governmental interest analysis is apparent as in determining this law, the courts have to take into account the choice of law principles stated in section 6 which lists, among other factors, "the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue."[154] Furthermore, the courts are also requested to take into account the "justified expectations" of the parties.[155]

The Australian Law Reform Commission[156] has proposed that the forum must apply the international mandatory rules of a third country if the connection is "the most real and substantial",[157] by which they mean that the mandatory rules of the objective proper law must be applied.[158] In contrast, various other Conventions do not insist that the law of the third country must be the objective applicable law. For example, Article 16(2) of the Hague Convention on the Law Applicable to Trusts and on their Recognition of 1985 provides that "in exceptional circumstances", the forum has a discretion to apply the international mandatory rules of third States if that State "has a sufficiently close connection with the case".[159] Article 16 of the Hague Convention of the Law Applicable to Agency 1978 gives the forum a discretion to apply the "mandatory rules of any State with which the situation has a significant connection" while Article 11 of the Inter-American Convention on the Law Applicable to International Contracts permits the forum to apply "the mandatory provisions of the law of another State with which the contract has close ties".[160] Article 9(2) of the

[152] Hartley, *supra* n 9, 359; Lando, *supra* n 146, 40.
[153] S 188.
[154] S 6(2)(c).
[155] S 6(2)(d).
[156] *Choice of Law (Report No 58)*(Canberra, Australian Government Publishing Service, 1992).
[157] *Ibid*, 179: Clause 9(9) of the Draft Choice of Law Bill 1992. There is no element of discretion for the forum.
[158] *Ibid*, 93 (para 8.36).
[159] The United Kingdom did not enact Article 16(2). States that have ratified the Convention without entering a reservation against Article 16(2) are Australia, Italy, Malta and the Netherlands. Liechtenstein and San Marino (non-Member States) also acceded to the Convention without making a reservation against Article 16(2).
[160] Whilst it is true that these two Conventions have not been ratified by many States and the Australian Choice of Law Bill has not been implemented, that these instruments provide for direct application of a third country's laws illustrates that the principle has support in many disparate corners of the world.

Basel Resolutions of the Institute of International Law states that the mandatory rules in the international sense of a third country can override the chosen law if there is a "close link" between the contract and the third country and if they "further such aims as are generally accepted by the international community". This last proviso is not found in other provisions and proposals[161] and given that there was no international consensus about the Prohibition in the 1920s or the trade embargoes against South Africa in the 1950s,[162] is probably too nebulous a concept to be practicable.

Lastly, mention must be made of Article 19(1) of the Swiss Private International Law Statute 1987.[163] This permits the court "to take into consideration" the mandatory law of a third State "if interests that are according to Swiss views legitimate and clearly overriding so require and the case is closely connected to that law". Article 19(2) goes on to give additional guidance as to how the discretion should be exercised: "whether such a provision should be taken into account depends on its policy and its consequences for a judgment that is fair according to Swiss views". It is clear that Swiss attitudes as to the interests of the third country and outcome of the case if the third country's laws are applied are paramount. In addition, the court must balance party autonomy with the desire of the third State in having its laws applied.

(c) The Rome Convention and the Proposed Rome I Regulation

Article 16, which permits application of forum public policy, has been mentioned above. There is however, no provision which caters for the application of the public policy of a third country.[164] In contrast, a number of provisions provide for the application of the mandatory rules of a third country. These provisions will now be looked at. Discussion will take place on the basis of the Rome Convention although relevant changes effected by the proposed Rome I Regulation will be discussed.

(i) Special Contracts: Articles 5 and 6

Weaker party protection is one area where it is readily acknowledged that a third country's laws may have a role to play. This area has so far not been touched upon as this article is concerned with the general issues concerning the application of a third state's mandatory rules and public policy and not the specific policy reason of weaker party protection. However, special provisions in the Rome Convention safeguard a weaker party's interests by providing for applica-

[161] Nygh, *supra* n 25, 222.
[162] *Ibid*, 226.
[163] This is a general provision which is not confined to contract choice of law.
[164] Whether this omission is sound is considered *infra*, section D.3.

tion of the mandatory rules of a third country. The relevant provisions will therefore be looked at briefly for the sake of completeness.

Articles 5 and 6 of the Rome Convention ensure that employees and consumers are not deprived of the protection offered by the domestic mandatory rules of the law of the country which would have been the applicable law of the contract but for the choice of a different law. Thus, a consumer will, if certain criteria are fulfilled, have the benefit of the mandatory rules of the law of the country of his habitual residence.[165] An employee will be able to rely on the mandatory rules of either the law of the country in which he habitually carries out his work in performance of the contract, or the law of the country in which the place of business through which he was engaged is situated.[166] The policy behind these special choice of law rules, that is, that freedom of contract should be curtailed where both parties are not of equal bargaining power,[167] is maintained in the proposed Rome I Regulation. In fact, Article 5, which covers consumer contracts, has now been altered so that the applicable law for consumer contracts is the law of the consumer's habitual residence; there is no longer any need separately to provide for the application of the mandatory rules of the law of the consumer's habitual residence. However, the draft Articles 5(2) and 5(3) limit the application of Article 5(1); Article 5(2) by laying down certain conditions to be fulfilled before one can rely upon Article 5(1), and Article 5(3) by excluding certain types of contracts from its scope. Thus, the protection offered to the weaker party is not all encompassing. This also links in with the point that imbalances in bargaining strength exist outside the typical consumer and employee situations. For example, there may be a difference in strength in cases of companies entering into contracts with each other, such as agency and franchise contracts.[168] In these situations, the ability of a court to take into account a third state's laws could offer protection to parties who do not fall within the conventional "weaker parties" situation. In addition, the justifications set out above[169] demonstrate that a third country could have a legitimate interest in having its public policy and mandatory rules applied to a contract even where this protectionist dimension does not exist. The other provisions that will be considered fall within this scenario.

(ii) Article 3(3)

Article 3(3) states that where the parties have chosen a foreign law and "all the other elements relevant to the situation at the time of the choice are connected with one country only", this "shall not prejudice . . . the application of rules of

[165] Article 5(2).
[166] Article 6(2).
[167] *Jaffey*, *supra* n 33, 235.
[168] Nordic Group for Private International Law, *supra* n 110, 45; Philip, *supra* n 122, 105.
[169] Section C.1.

the law of that country which cannot be derogated from by contract".[170] The reference here, as in Articles 5 and 6, is to domestic mandatory rules.[171]

Article 3(3) operates in the limited circumstance where the parties have chosen a foreign law to govern what is as good as a domestic English contract apart from the choice of a foreign law, or in the converse situation where the parties have chosen English law to govern what is as good as a, for example, domestic French contract.[172] As Boggiano notes, Article 3(3) "prevents a fictitious internationalization of an objectively domestic contract simply to oust mandatory rules".[173] In other words, parties should not be allowed to evade the operation of rules of law by the simple expedient of choosing a foreign law to govern what is otherwise a domestic contract. Paradoxically, the contract's "home state" is considered as the "third country" here.

The academic consensus is that application or non-application would depend on whether the law of the country to which the mandatory rule belongs considers the rule to be applicable in the particular context before the court.[174] However, the forum retains some discretion as it has to decide whether the relevant elements for the purposes of Article 3(3) are connected with one country only.[175] The Giuliano–Lagarde Report does not give much guidance on this issue at all.[176] Lasok and Stone argue that a broad construction should be given to "relevant elements of the situation" and give as an example a contract that may have some connection with other countries because it is part of a string as still falling under Article 3(3) as "it is entirely reasonable for parties to arrange that the whole chain be governed by the same law in order to ensure that a seller who

[170] This provision has not been changed substantively in the proposed Rome I Regulation and is now Article 3(4) in the proposal.

[171] See *supra*, section B.2.

[172] See *Bankers Trust International plc v RCS Editori SpA* [1996] CLC 899 at 905; *Shell International Petroleum Co Ltd v Coral Oil Co Ltd* [1999] 1 Lloyd's Rep 72, 78–79; *NM Rothschild Ltd v Equitable Life Assurance Society & ORS* [2002] EWHC 1021 (QB); *Caterpillar Financial Services Corporation v SNC Passion* [2004] EWHC 569 (Comm), [2004] 2 Lloyd's Rep 99 for unsuccessful attempts to invoke Article 3(3).

[173] A Boggiano, *International Standard Contracts: The Price of Fairness* (London, Graham & Trotman/ Martinus Nijhoff, 1991), 46.

[174] Philip, *supra* n 122, 95; Morse, *supra* n 66, 123; *Cheshire and North*, *supra* n 32, 558. For example, even though the requirement of consideration for a valid contract under English law is a domestic English mandatory rule, it may well be that an English court will not insist on its application where the parties have chosen a foreign applicable law as it is a rule which is neither protectionist nor based on strong public policy grounds: Fawcett *et al*, *supra* n 139, 691 (footnote 217).

[175] Philip, *supra* n 122, 95; Morse, *supra* n 66, 123. According to *NM Rothschild Ltd v Equitable Life Assurance Society & ORS* [2002] EWHC 1021 (QB), the place of domicile of a lending bank is a relevant factor under Article 3(3). In a case decided under the common law, the fact that the plaintiff company was incorporated in Hong Kong did not stop the court from striking out a choice of law clause for Hong Kong law as not being made in good faith when all other factors were connected with Queensland: *Golden Acres Ltd v Queensland Estates Pty Ltd* [1969] Qd R 378. If the same approach is taken under the Convention, the place of incorporation might not be a relevant factor under Article 3(3): Fawcett *et al*, *supra* n 139, 691 (footnote 213).

[176] *Supra* n 32, 18.

is held liable to his buyer shall have a claim to indemnity from his own seller".[177] However, a stricter approach is suggested by Cooke J's *dictum* in *Caterpillar Financial Services Corporation v SNC Passion*: "It is noteworthy that Article 3(3) refers to elements 'relevant to the situation' which is wider than 'elements relevant to the contract'."[178] His Lordship cited[179] with approval a passage in *Dicey and Morris* where the authors conclude that Article 3(3) does not apply to contracts, such as string contracts,[180] which are apparently connected with one country but have some connection with other countries.[181]

Insofar as Article 3(3) is geared towards a *purely* domestic contract which has been "internationalised" by a choice of a foreign governing law, this strict approach must be correct.[182] However, one of the purposes behind Article 3(3) is to prevent "fraudulent evasion" of the law.[183] If this is so, why should non-essential connecting factors be considered as "relevant to the situation"? For example, in a contract expressed to be governed by English law, if both parties are German and the contract is for the sale of goods in Germany, it should not matter that the goods were manufactured in France.[184] The connection with France is incidental and it would be unlikely for the parties to have in mind evasion of mandatory provisions of French law which would have been applicable if French law was the applicable law of the contract, rather than evasion of similar provisions of German law. In fact, if a narrow construction is taken of Article 3(3) so that the connection with France invalidates reliance on Article 3(3), there may be no means by which a court could superimpose the domestic mandatory rules of German law upon the contract. If Germany is the forum, only its international mandatory rules would be applicable under Article 7(2). If, say, England provides the forum, not even German international mandatory rules,[185] much less German domestic mandatory rules, would be applicable. Thus, a narrow reading of what the "relevant elements of the situation" constitutes runs the risk of subverting the aim of preventing evasion of the law.

[177] Lasok and Stone, *supra* n 55, 377.
[178] [2004] EWHC 569 (Comm), [2004] 2 Lloyd's Rep 99, 103 (para 18).
[179] [2004] EWHC 569 (Comm), [2004] 2 Lloyd's Rep 99, 103 (para 19).
[180] The other example given is insurance arrangements.
[181] *Supra* n 23, 1220 (para 32–069).
[182] The Giuliano–Lagarde Report, *supra* n 32, 18, states that Article 3(3) represented a compromise between two ideas: on the one hand, that the Convention should only apply to an international situation, and on the other hand, that there should be complete freedom to choose a foreign law in good faith.
[183] As is made clear by the Explanatory Memorandum with respect to Article 3(4) of the proposed Rome I Regulation, which transposes Article 3(3) of the Rome Convention: COM (2005) 650 final, 6.
[184] See Lasok and Stone, *supra* n 55, 377.
[185] Due to the reservation against Article 7(1): section 2(2) of the Contracts (Applicable Law) Act 1990.

(iii) Article 10(2)

With regard to contracts that are truly international in nature, provision for recourse to the law of a third country, in particular the *lex loci solutionis*, can be found in Article 10(2). This sets out that: "In relation to the manner of performance and the steps to be taken in the event of defective performance regard shall be had to the law of the country in which performance takes place." This should be contrasted with Article 10(1)(b), which provides that the applicable law of the contract governs its performance.[186] The difference between "manner of performance" and "performance" is not clearly articulated. The Giuliano–Lagarde Report notes that the former is a concept that is interpreted differently in various laws; hence there was a reluctance to give a "strict definition" of the phrase.[187] Nevertheless, the Report does state that the *lex fori* will determine what is meant by "manner of performance".[188] Kaye argues that the phrase should be taken to include non-performance,[189] in which case a party who does not perform his obligation because the act is illegal by the *lex loci solutionis* would be absolved from liability for non-performance.[190] However, it appears that Article 10(2) covers the more "minor" details of the contract; for example, the Giuliano–Lagarde Report gives the following as examples of matters falling within its scope: rules governing public holidays, the manner in which goods are to be examined, and the steps to be taken if they are refused.[191] *Cheshire and North*[192] observe that under the common law, "manner of performance" was similarly interpreted to cover minor issues such as the currency in which a debt is dischargeable[193] and the date at which lay days begin to run.[194] *Dicey and Morris* also conclude that the scope of the law of the place of performance under Article 10(2) "is confined to matters concerned with the mode, place and time of performance, and does not extend to matters which affect the substance of the obligation".[195]

In *East West Corporation v DKBS 1912*,[196] Thomas J thought that the common law distinction between the substance of the performance, which is governed by the proper law of the contract, and the mode of performance, which is governed

[186] Both Articles 10(1)(b) and 10(2) are unchanged in the proposed Rome I Regulation (now Articles 11(1)(b) and 11(2) respectively).
[187] *Supra* n 32, 33.
[188] *Ibid.*
[189] Kaye, *supra* n 53, 304.
[190] A similar argument is made with respect to supervening illegality according to the law of the place of performance by Diamond, *supra* n 16, 296; criticised by *Cheshire and North*, *supra* n 32, 602.
[191] *Supra* n 32, 33.
[192] *Supra* n 32, 597.
[193] *Mount Albert Borough Council v Australasian Temperance and General Mutual Life Assurance Society* [1938] AC 224, 241.
[194] *Norden Steamship Co v Dempsey* (1876) 1 CPD 654, esp 662–63.
[195] *Supra* n 23, 1263 (para 32–195).
[196] [2002] EWHC 83; [2002] 2 Lloyd's Rep 182; hereafter *East West.*

by the law of the place of performance, was maintained by Article 10 of the Rome Convention.[197] *East West* concerned a contract for the delivery of goods to Chile, the contract being contained in bills of lading which were governed by English law. The defendant carriers had delivered goods to a licensed customs warehouse in Chile and the goods were thereafter released without presentation of the original bills of lading to a third party. The third party defaulted on some of the payments owed to the claimants for the goods. The claimants sued for the loss caused by the failure of the defendants to deliver the goods only against presentation of the bill of lading as required under English law. Thomas J held that regard had to be had to provisions of the law of Chile under which original bills of lading had to be retained by the Chilean customs and could only be presented to the carrier and then returned. However, since the defendant carriers could have contracted with the warehouse operator on terms that an original bill of lading had to be presented before the goods were released, they were liable for the loss.[198]

Despite recognising that the mode under which the delivery obligation is discharged is modified by provisions in the law of Chile specifying the manner in which cargo in Chile had to be delivered, Thomas J went on to say that this modification of discharge by the law of Chile "is in no way inconsistent with the basic obligation under these bills of lading in English law to deliver against presentation of the bill of lading".[199] He left open the situation if Chilean law had been incompatible with English law.[200] Thus, the question arises as to whether regard can be had to the law of the place of performance with respect to the manner of performance only to the extent that it is not incompatible with the governing law of the contract.

On the one hand, allowing the law of the place of performance effect with respect to the mode of performance only if it is compatible with the governing law of the contract seems to be in keeping with the phrases used in Article 10. Article 10(1)(b) establishes that the applicable law of the contract "shall govern" performance, while Article 10(2) uses the phrase "regard shall be had" in relation to the law of the place of performance. The latter phrasing is less imperative than the former. In addition, manner of performance could be argued to comprise a subset of the substantive obligation of performance. Therefore one could argue that it is the applicable law of the contract which is the overarching governing law with respect to all aspects of performance.

[197] [2002] 2 Lloyd's Rep 182, 194 (para 64).

[198] Under English law, the bill of lading should have been surrendered to and kept by the defendant carriers: [2002] 2 Lloyd's Rep 182, 206 (para 134).

[199] [2002] 2 Lloyd's Rep 182, 206 (para 134).

[200] [2002] 2 Lloyd's Rep 182, 206 (para 135). See also *Import Export Metro Ltd v Compania Sud Americana de Vapores SA* [2003] 1 Lloyd's Rep 405, 416 (para 25).

On the other hand, insistence on compatibility with the applicable law of the contract could make the existence of Article 10(2) meaningless in some cases.[201] This is because disputes may arise where the applicable law of the contract and the law of the place of performance have different rules and the parties are seeking to argue that the rule pertains to "performance" or "manner of performance" respectively. To say that one concerns the substance and the other the minor aspects of performance is only to establish a very general framework in which grey areas remain. For example, in the Giuliano–Lagarde Report, time of delivery is listed as an issue going to the "performance" of the contract[202] whilst rules governing public holidays is cited as a matter falling within "manner of performance".[203] Let us assume that there is a contract governed by Ruritanian law to deliver food in Utopia for a Christmas party and Utopian law forbids such delivery on a religious holiday. No such bar operates under Ruritanian law. Is the Utopian rule one pertaining to "time of delivery" or a "rule governing public holidays"? To look at this from another angle, one could potentially interpret the contract as being in substance for the delivery of food in Utopia on Christmas day, or alternatively, one could ignore the motive of the contract and construe it as being in substance for the delivery of food in Utopia, with the question of whether delivery can take place on a certain date being classified as an issue of "manner of performance". The point is that until one is able to delineate clearly between the two concepts of "performance" and "manner of performance", insistence on compatibility between the applicable law of the contract and the law of the place of performance would rob Article 10(2) of significance. Alternatively, even if one could make a clear delineation between the two concepts, it surely then is not imperative for the applicable law of the contract to have a say over the merely minor aspects of performance. Therefore, it is submitted that the better view is that compatibility between the law of the place of performance and the applicable law of the contract as to the manner of performance should not be required under Article 10(2).

(iv) Article 7(1)

The most crucial provision in the Rome Convention for the purposes of this article is Article 7(1). This envisages a more substantive application of the law of a third country than Article 10(2) and provides that:

[201] The Giuliano–Lagarde Report states that the applicable law of the contract would "embrace the totality" of conditions going towards performance of the obligation arising under the contract "but not the manner of its performance" (*supra* n 32, 32). This implies that the law of the place of performance will prevail over the applicable law of the contract in cases of conflict over the manner of performance. This is also the view taken by Fawcett *et al*, *supra* n 139, 720 (para 13.161).

[202] *Supra* n 32, 32. It has been noted that this is controversial as time of delivery also appears to relate to the manner of performance: Fawcett *et al*, *ibid*, 721 (para 13.163).

[203] *Supra* n 32, 33.

> "When applying under this Convention the law of a country, effect may be given to the mandatory rules of the law of another country with which the situation has a close connection, if and in so far as, under the law of the latter country, those rules must be applied whatever the law applicable to the contract. In considering whether to give effect to these mandatory rules, regard shall be had to their nature and purpose and to the consequences of their application or non-application."

Article 7(1) is based on the *ALNATI*[204] case[205] and the wording suggests that it owes much to Article 16 of the Hague Convention on Agency.[206] There were fears that Article 7(1) introduced an unacceptable level of uncertainty into the law. First, "close connection" was thought to be vague;[207] secondly, the provision left a discretion in the hands of the courts as to whether to give effect to the identified third country's mandatory rules.[208] These fears led the United Kingdom to enter a reservation against it.[209]

However, the European Commission has now published its proposal for a Rome I Regulation.[210] Article 8(1) defines mandatory rules as "rules the respect for which is regarded as crucial by a country for safeguarding its political, social or economic organisation to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation".[211] Article 8(3) preserves and expands on Article 7(1):

> "Effect may be given to the mandatory rules of the law of another country with which the situation has a close connection. In considering whether to give effect to these mandatory rules, courts shall have regard to their nature and purpose in accordance with the definition in paragraph 1 and to the consequences of their application or non-application for the objective pursued by the relevant mandatory rules and for the parties."

[204] HR 13 May 1966, Nederlandse Juresprudentie 1967 no 3, annotated by LJ Hijmans van den Bergh; (1967) 56 *Revue Critique de droit international privé* 522. Facts above, text to n 149.

[205] Giuliano–Lagarde Report, *supra* n 32, 26. For differences between the *ALNATI* principle and Article 7(1), see J Schultsz, "Dutch Antecedents and Parallels to Article 7 of the EEC Contracts Convention of 1980" (1983) 47 *Rabels Zeitschrift* 267, 276–77.

[206] Plender, *supra* n 110, 185 (para 9–04).

[207] The Giuliano–Lagarde Report gives two examples of when the "close connection" requirement would be fulfilled. One is when the third country is the place of performance and the other is when one of the parties is resident or has his main place of business in that country: *supra* n 32, 27. Mann has observed that Article 7(1) allows the third country's law a far greater effect than the governing law or the *lex fori*. Whereas a "close connection" is sufficient to trigger consideration of the mandatory rules of a third country, "[f]or the proper law to apply there must be a real choice by the parties or a close and substantial connection. For the public policy of the forum to apply some elementary principle of justice or morality must be at stake": *supra* n 72, 36. Cf Jackson, *supra* n 9, 73–74.

[208] *Cheshire and North*, *supra* n 32, 584.

[209] Section 2(2) of the Contracts (Applicable Law) Act 1990.

[210] COM (2005) 650 final.

[211] Inspired by the passage in *Arblade* (Case C–369/96), para 30; cited *supra*, text to n 29.

There are several things to note about this development. First, the legal basis for the conversion of the Rome Convention into a Regulation is Article 65(b) of the Treaty establishing the European Community. This allows measures for the promotion of the "compatibility of the rules applicable in the Member States concerning the conflict of laws and of jurisdiction" to be adopted "in so far as necessary for the proper functioning of the internal market". However, doubts have been raised as to the Community's competence in an area which is not restricted to intra-Community fact situations.[212] The UK Government gives the example of an English court hearing a dispute between two South Korean domiciliaries regarding an alleged breach of contract committed outside the European Union. Here, the connection with the Union and the proper functioning of the internal market is "highly tenuous".[213] Similar reservations[214] regarding the Community's competence under Article 65(b) with respect to the proposed Rome II Regulation on the Law Applicable to Non-Contractual Obligations have not prevented the Commission from asserting its "discretion to determine whether a measure is necessary for the proper functioning of the internal market".[215] Nevertheless, despite the dubiousness of the legal basis for conversion into a Regulation of universal application, the corollary, ie, to have one choice of law system for intra-Community disputes with Member States individually adopting another system for extra-Community cases, would result in complexity and confusion.[216]

Secondly, the proposed Rome I Regulation falls within Title IV of the Treaty establishing the European Community and does not apply to the United Kingdom by virtue of the Protocol annexed to the Treaty unless the United Kingdom exercises its right to opt into the instrument. It is improbable, notwithstanding doubts as to its legal basis, that the United Kingdom will not opt into the Regulation, not least because it has enacted the Rome Convention into its law since 1990.[217]

Thirdly, reservations are generally not compatible with Regulations and a right to make reservations is not conferred in the draft Regulation. Unless this is introduced, or Article 8(3) is discarded in the final version of the Regulation, the discretion directly to apply a third country's mandatory rules will become part of

[212] The Rome Convention and the draft Rome I Regulation are universal in application; see Article 1(1) of both instruments.

[213] *Response of the Government of the United Kingdom*, para 4. Document accessible online at: http://www.europa.eu.int/comm/justice_home/news/consulting_public/rome_i/doc/united_kingdom_en.pdf.

[214] Select Committee on European Union, *Eighth Report of Session 2003–04: The Rome II Regulation – Report with Evidence (HL Paper 66)* (2004) (London, HMSO), 18–24 (paras 50–72); document also accessible online at: http://www.publications.parliament.uk/pa/ld200304/ldselect/ldeucom/66/6602.htm (as on 23 February 2006).

[215] COM (2003) 427 final, 6 (hereafter the "proposed Rome II Regulation"). The most recent revised version of the proposed Regulation can be found at COM (2006) 83 final.

[216] See Max Planck Institute for Foreign Private and Private International Law, *supra* n 4, 11.

[217] Contracts (Applicable Law) Act 1990.

the law of the United Kingdom. That this will be the case seems more likely than not given that the counterpart to Article 8(3) in the proposed Rome II Regulation is preserved in the most recent version of the Rome II proposal[218] thereby indicating the Commission's commitment to the principle of direct applicability of a third country's mandatory rules.[219] It will be obvious from the arguments made in the preceding sections that this author thinks that this would be a welcome development in English law.

A few points may be further developed in support of this position. Courts may prefer to utilise their traditional indirect method of taking into account a third country's laws. However, dependence upon application of forum public policy indirectly to give effect to the mandatory rule of a third country is restricted given the negative phrasing of Article 16 which envisages disapplication, not application, of a foreign rule.[220] Thus, *Foster* and *Regazzoni* cannot be considered to have survived the Rome Convention.[221] There has been an attempt to argue that the *Foster* line of cases could instead be preserved through application of Article 7(2) but the basis for this argument is ambiguous.[222] Hartley submits that the cases involve application of a domestic English rule which can be regarded as a mandatory rule for the purposes of Article 7(2).[223] How a domestic English rule would warrant application under Article 7(2) is unclear as an English domestic mandatory rule would only apply when English law is the applicable law of the contract, whereas Article 7(2) refers to mandatory rules which apply irrespective of the applicable law of the contract. In addition, as *Cheshire and North* point out, to construe a common law rule based on comity between nations as a domestic law rule is tantamount to a "fiction".[224] Thus, the fact that a case similar to *Foster* and *Regazzoni* which falls within the scope of the Rome Convention cannot, it would seem, be decided the same way in England points to there being a lacuna in the law and the need for a provision like Article 7(1).[225]

It is also worth reiterating that the indirect method of application is dependent upon opportunities to take into account a third country's laws existing within the governing law of the contract or the *lex fori*,[226] rather than focusing on the integrity of the third country's rule itself. For example, Vischer points out that the focus on immorality under German law in cases like *Kulturgüterfall* [227]

[218] Article 13(2), COM (2006) 83 final.
[219] In addition, no objections to this principle appear to have been raised in the European Parliament at first reading in plenary session on 6 July 2005: A6-0211/2005 (Rapporteur: D Wallis).
[220] *Supra*, text to nn 51–55.
[221] See *supra*, text to n 55.
[222] Hartley, *supra* n 9, 403. See also *Jaffey*, *supra* n 33, 250.
[223] Hartley, *supra* n 9, 403.
[224] *Cheshire and North*, *supra* n 32, 586.
[225] It is somewhat ironic that it is countries such as the UK and Germany, both of which believe that a third country's laws should be accorded respect, who have chosen to make a reservation against Article 7(1).
[226] *Supra*, section C.2(a).
[227] BGH, 22 June 1972; BGHZ 69, 82; facts *supra*, text to nn 97–99.

means that a contract will only be invalid if the foreign prohibition was already in force at the time of conclusion of the contract as an intentional evasion of supervening laws does not make sense.[228] Direct applicability under Article 8(3) would better reflect the legitimate interest of a third country in having its law applied where there is a requisite close connection and the underlying comity-based reasons for taking into account a third country's laws which were set out above.[229]

Furthermore, although concerns about uncertainty will probably be raised against Article 8(3), these concerns could be overstated. There are no reports of insurmountable problems of uncertainty, or even costs and workload for courts from countries which did enact Article 7(1) into their laws.[230] In addition, a narrow construction of Article 8(3) would cut down on uncertainty. The close connection for both Article 8(3) and Article 7(1) is phrased in relation to the "situation". In the Giuliano–Lagarde Report, it is stated that the close connection must exist between the law of the third country and the contract as a whole, and the drafters rejected a proposal from one delegation that the connection must be between the point in dispute and a specific law.[231] Yet, if the "situation" concerns non-payment in Ruritania, it would be strange if the mandatory rules of Ruritania on payment are not referred to as being those of a country with a close connection under Article 7(1) merely because there is a close connection between the contract as a whole and Utopia, the place where the contract is concluded and where the seller has his main place of business.[232] Furthermore, the emphasis in the Giuliano–Lagarde Report on the close connection between the third country and the contract as a whole is arguably misplaced as one would not expect the mandatory rules of payment in Utopia to be relevant merely because there is a close connection between the contract and Utopia in a general sense. Article 8(3) would thus benefit from a narrower construction, ie, that the close connection must be between the specific aspect of the contract which is in dispute and the third country.[233] This narrow construction would better reflect circumstances where the third country has a legitimate interest in having its mandatory rules applied and serve to increase certainty by restricting the contexts in which a third country's mandatory rules may be considered relevant.

Certainty is also enhanced by the text of Article 8(3) which strives to give more pointers than its predecessor as to how courts should exercise their dis-

[228] Vischer, *supra* n 9, 171. On the issue of supervening illegality, see *infra* section D.1.

[229] Section C.1.

[230] Max Planck Institute for Foreign Private and Private International Law, *supra* n 4, 72. In fact, it has been argued that Article 7(1) actually introduces certainty into the law and that the indirect and *ad hoc* method that has been taken towards application of a third country's laws by English and German courts creates far more uncertainty and unpredictability: (2001) 114 *Harvard Law Review* 2462, 2468–77. See also Kaye, *supra* n 53, 253.

[231] *Supra* n 32, 27.

[232] Example derived from Kaye, *supra* n 53, 254–55.

[233] *Ibid*, 255. Cf (2001) 114 *Harvard Law Review* 2462, 2475–76.

cretion to apply a third country's mandatory rules.[234] For one, the court is now expressly directed to consider the objective pursued by the relevant mandatory rule. The echo with the US governmental interest analysis[235] is obvious and supports the narrow construction of Article 8(3) suggested above by focusing on the interest of the third country in having its laws applied. For another, the court has to consider the effect on the parties of application or non-application of the identified third country's mandatory rules. This is a new addition.[236] It presumably allows the court to take into account the parties' legitimate expectations as to whether the third country's mandatory rule applies. For example, if performance subsequently becomes illegal according to the law of the place of performance, non-application of the mandatory rule would expose the party carrying out performance to sanctions in the place of performance if the contract is enforced. In this situation, the parties' legitimate expectations would probably be that the performance should be abandoned and the court should take account of this.[237] However, a fine balance has to be wrought; the essence of a mandatory rule is that it embodies policies which are held to be of such importance by the country which enacts it so that the rule prevails over party autonomy and expectations.[238] If the third country is acknowledged to have the requisite "close connection" and the nature, purpose and object of its mandatory rule is such that application of it is legitimately warranted, the consequences of its application on the parties should not be given undue weight under Article 8(3).

In addition to guidance found in the text of Article 8(3) as to how courts should exercise their discretion, the body of common law cases whereby English courts have indirectly given effect to the *lex loci solutionis* contains principles that can inform and guide courts as to the future application of Article 8(3). The derivation of such principles is the aim of the next section.

D. *Lex Loci Solutionis*

Acceptance that courts should have a discretion directly to apply a third country's laws raises questions as to how the discretion should be exercised. Three issues spring to mind. First, in considering whether to give effect to a third country's mandatory rules, does it matter when a particular law is enacted? Secondly, references to the applicability of a third country's laws in the case law, conventions and provisions in the Rome Convention which were canvassed earlier have

[234] Cf Article 13(2) of the proposed Rome II Regulation, COM (2006) 83 final, which merely reiterates the text of Article 7(1) of the Rome Convention.
[235] See *supra*, section C.1(a).
[236] This consideration of the parties' interests is similar to Article 19 of the Swiss PIL Statute; see *supra*, section C.3(b).
[237] See *infra*, section D.1.
[238] Hartley, *supra* n 9, 364.

only referred to the third country's mandatory rules. What impact does the public policy of the third country have? Connected with this issue is whether a distinction should be made between the public policy of a third country and its mandatory rules. This will be the third issue discussed.

The classic example of a third country that has a legitimate interest in having its laws applied in an international contract is the place of performance. English courts have long given indirect effect to the *lex loci solutionis* under the common law. It is suggested that the answers to the three issues lie within an analysis of case law concerning the *lex loci solutionis*.

1. Is There a Distinction Between Existing and Supervening Illegality According to a Mandatory Rule of the *Lex Loci Solutionis*?

Cases such as *Foster v Driscoll*[239] and *Regazzoni v KC Sethia*,[240] which were discussed above, concerned existing illegality. The parties had agreed to break an existing mandatory rule of the place of performance. The principle that was established was that it was against the English public policy of maintaining good relations with friendly foreign states to enforce contracts that are illegal according to the law of the place of performance, and this principle applied regardless of the governing law of the contract. It has been argued above that the cases should be seen as instances where the English court ultimately applied the mandatory rules of a third country, ie, the *lex loci solutionis*.

The question that needs to be considered here is whether the *Foster* principle applies when the issue is supervening, as opposed to existing, illegality according to the law of the place of performance. Should the forum give effect to a mandatory rule of the place of performance which only becomes the law after the making of the contract?

In *Ralli Bros v Compania Naviera Sota y Aznar*,[241] a contract governed by English law concerning the charter of a vessel provided for payment at a certain rate to be made in Spain. Subsequently, the contractual rate became illegal under Spanish law which decreed a lower maximum rate. The Court of Appeal held that the plaintiff failed in his action for payment at the higher contractual rate. Scrutton LJ stated:

> "where a contract requires an act to be done in a foreign country, it is, in the absence of very special circumstances, an implied term of the continuing validity of such a provision that the act to be done in the foreign country shall not be illegal by the law of that country".[242]

[239] [1929] 1 KB 470.
[240] [1958] AC 301.
[241] [1920] 2 KB 287; hereafter "*Ralli Bros*".
[242] *Ibid*, 304.

There is some doubt as to whether the rule laid down in *Ralli Bros* is a domestic English rule or a conflicts rule. There have been contradictory dicta on this point.[243] The prevailing academic view is that it is a domestic rule of English law, ie, it is the application of English domestic contract law on frustration under which a contract that subsequently becomes illegal to perform is unenforceable.[244] As such, it is only applicable when the governing law of the contract is English law. On this reasoning, in all cases of subsequent illegality by the *lex loci solutionis*, it is for the governing law of the contract to determine the effects of such illegality.[245]

However, Kaye[246] suggests that the comity reasoning present in cases such as *Foster*[247] and *Regazzoni*[248] could also be used as a more general basis to support the decision in *Ralli Bros*; ie, a contract that stipulates performance that subsequently becomes illegal by the *lex loci solutionis* would be against the public policy of the forum of maintaining good relations with friendly foreign states. This is a subtly different proposition from that which was rejected by Goff J in *Toprak v Finagrain* when he refused to merge the principles in *Ralli* and *Foster* into one wider principle.[249] In *Toprak*, the buyers were a Turkish state economic enterprise while the sellers were a Swiss subsidiary of a New York company. The contract was governed by English law and provided for payment by means of a letter of credit confirmed by a first-class US or West European bank. The Turkish buyers wanted to open a letter of credit in Turkey and had to obtain the necessary foreign exchange allocation from the Turkish Ministry of Finance in accordance with Turkish law. However, authorisation was not given. They argued that it must have been contemplated by both parties that the buyers would have to open the letter of credit in Turkey. Since the appropriate consent was not obtained, they were relieved from liability owing to illegality by the law of the place where it was contemplated by the parties that the contract would be performed. Goff J held that there was no finding of fact that the parties had contemplated that the letter of credit would be opened in Turkey; there was nothing under the contract

[243] For *dicta* which suggests *Ralli* is a conflicts rule, see *Regazzoni* [1958] AC 301, 322, *per* Viscount Simonds; *Cantiere Navale Triestina v Handelsvertretung* [1925] 2 KB 172, 208, *per* Atkin LJ. In *Zivnostenka Bank v Frankman* [1950] AC 57, 78, Lord Reid observed that it is "settled law that, whatever be the proper law of the contract, an English court will not require a party to do an act in performance of a contract which would be an offence under the law in force at the place where the act is to be done"; whereas in *Kahler v Midland Bank Ltd* [1950] AC 24, 48, his Lordship stated that: "the law of England will not require an act to be done in performance of an English contract if such act . . . would be unlawful by the country in which the act is to be done".

[244] *Dicey and Morris*, *supra* n 23, 1246–48; Nygh, *supra* n 25, 224; Hartley, *supra* n 9, 392; FA Mann, "Proper Law and Illegality in Private International Law" (1937) 18 *British Yearbook of International Law* 97, 110–11; *Cheshire and North*, *supra* n 32, 601.

[245] Under the Rome Convention, this would fall within Article 10(1)(b) of the Rome Convention.

[246] Kaye, *supra* n 53, 240–41.

[247] [1929] 1 KB 470.

[248] [1958] AC 301.

[249] [1979] 2 Lloyd's Rep 98, 107 (hereafter "*Toprak*").

which stipulated so.[250] Furthermore, as the Court of Appeal emphasised, the place of performance was not Turkey and therefore illegality by Turkish law afforded no defence to the claim.[251] Compliance with formalities necessary within Turkey were the buyers' responsibility and the sellers were only concerned that there should be an irrevocable letter of credit confirmed by a first-class US or West European bank.[252]

Goff J refused to combine the *Ralli* and *Foster* principles into a proposition that "English law will not enforce a contract where performance involves the doing in a foreign friendly country an act which is illegal by the law of that country."[253] His worry there was that the word "involves" was ambiguous and could be construed as including the word "contemplates". Thus, it appears as if Goff J's reluctance in drawing a parallel between *Ralli* and *Foster* is due to the fact that doing so could have raised the danger that the law of a friendly foreign country which is not the contractually stipulated place of performance but rather the location of incidental acts which are contemplated by both parties may be carried out in fulfilment of the main performance obligation would nullify or render a contract unenforceable. If this is the correct basis for Goff J's reluctance, then his worry can be put to rest. As Goff J himself stated earlier in his judgment, "performance" under the *Ralli Bros* principle can only refer to performance which is necessary and contractually required under the contract,[254] not performance of incidental acts leading up to the main contractually stipulated performance. One of the parties must be assumed to take on the risk of being unable to perform the incidental acts.

Comity was not expressly discussed in the *Ralli Bros* judgments, but as Goff J recognised, *Ralli Bros* and *Foster* were "related in the sense that they spring from the root principle of comity, a root which . . . is capable of new growth from time to time".[255] Therefore, it is suggested that operation of the *Ralli Bros* principle should not depend upon English being the governing law of the contract. It should be extended[256] and regarded as a conflicts rule applicable whatever the governing law of the contract.[257] However, it has been argued that the comity argument is less strong where the parties act in good faith and performance only subsequently becomes illegal because of a change in the law of the place of

[250] *Ibid*, 105.
[251] *Ibid*, 114.
[252] *Ibid*, 105 (Goff J) and 114 (CA).
[253] *Ibid*, 107.
[254] *Ibid*, 106. See also *Kleinwort, Son & Co v Ungarische Baumwolle Industrie Aktiengesellschaft* [1939] 2 KB 678, 687–88.
[255] *Toprak*, *supra* n 249, 107.
[256] On the assumption that the academic views as to the domestic nature of the *Ralli Bros* principle is correct.
[257] This proposition would be acceptable to *Dicey and Morris*. The authors state that if the contract is governed by the law of a foreign country and there is supervening illegality according to the foreign *lex loci solutionis*, Article 7(1) of the Rome Convention would allow application of the law of the latter country if it were part of English law: *supra* n 23, 1248–49 (para 32–146).

performance.[258] This is true, but the comity argument is still present. In addition, arguably the parties' expectation in this situation is that the contract would not be enforced as enforcement would expose the party who has to carry out that particular performance to sanctions in the place of performance. Furthermore, this reasoning would be in line with the draft Rome I Regulation. Under Article 8(3), courts are directed to have regard to the consequences of application or non-application of the third country's mandatory rules for the parties. Therefore, it is suggested that a court should give effect to the law of the place of performance whatever the governing law of the contract in cases of initial[259] *and* supervening illegality.[260]

2. Operation of the Public Policy of the *Lex Loci Solutionis*

In *Lemenda Ltd v African Middle East Co*,[261] the parties entered into a contract whereby the plaintiff would use his influence with members of the Qatar government to procure the renewal of a supply contract between the defendant and the national oil corporation of Qatar, which was controlled by the government of Qatar. The governing law of the contract was English law. It was clear that English contracts for the use of influence on public persons to obtain a benefit for another person in return for a commission were against English public policy. It was found that such contracts were also against the internal public policy of Qatar. The contract was not enforced. The reasoning ran thus: the fact that the contract was contrary to the public policy of Qatar, the place of performance, could not, of itself, constitute a ground for non-enforcement of the contract. However, the public policy of Qatar may be a relevant factor in considering whether the contract ought not to be enforced under the operation of English public policy. The moral principles at stake here were held to be not "so weighty as to lead an English court to refuse to enforce an agreement regardless of the country of performance and regardless of the attitude of that country to such a practice".[262] Nevertheless, since the domestic public policy of England and the

[258] *Cheshire and North*, *supra* n 32, 602–03.

[259] *Foster* [1929] 1 KB 470; *Regazzoni* [1958] AC 301.

[260] Singaporean courts have not tended to draw a distinction between *Ralli Bros* and *Foster*: *Abdul Shukor v Hood Mohamed* [1968] 1 MLJ 258; *Overseas Union Bank Ltd v Chua Kok Kay* [1993] 1 SLR 686, 696 and 697. See D Chong, "Contractual Illegality and Conflict of Laws" (1995) 7 *Singapore Academy of Law Journal* 303, 343–44. Furthermore, section 9(10) of the Australian Choice of Law Bill applies regardless of the proper law of the contract and no distinction is made between existing and supervening illegality: ALRC, *Choice of Law (Report No 58)*, *supra* n 156, 86–87 (paras 8.16–17). Cf s 202(2) of the *Restatement (Second) of Conflict of Laws* where the effect of supervening or existing illegality according to the law of the place of performance is to be determined by the applicable law of the contract (comment c).

[261] [1988] QB 448 (hereafter "*Lemenda*").

[262] *Ibid*, 461. One would assume that if the contract was one of actual bribery, it would have been void as being against the head of English public policy covering laws repugnant to English principles of morality. See *AG for Hong Kong v Reid* [1994] 1 AC 324, 330, *per* Lord Templeman: "Bribery is an evil practice which threatens the foundations of any civilised society."

public policy of Qatar coincided on this point, the contract was not enforceable. The rationale of the case is that:

> "[T]he English courts should not enforce an English law contract which falls to be performed abroad where: (i) it relates to an adventure which is contrary to a head of English public policy which is founded on general principles of morality, and (ii) the same public policy applied to the country of performance so that the agreement would not be enforceable under the law of that country."[263]

Was English public policy there functioning as the public policy of the forum or of the proper law? This is a difficult question in which it may not be sensible to draw a line as the fact that English law was both the *lex fori* and the governing law of the contract must surely have had an impact on the decision. Indeed, Phillips J observed that in this particular situation, "international comity combines with English domestic public policy to militate against enforcement".[264] This suggests that the decision in *Lemenda* was a combination of two factors: the role of the forum in preserving comity to take account of the fact that performance was against the public policy of the *lex loci solutionis*, and domestic public policy, in play because English was the governing law of the contract, that took the same view as the place of performance.[265]

What if the governing law of the contract was not English law but, say, Ruritanian law, under which the contract was perfectly valid but which was against the public policy of the place of performance, say, Utopia, and also against the public policy of England? Would English public policy then step in to strike down the contract?

Some guidance on this question may be derived from a case concerning the enforcement of an arbitral award.[266] In *Westacre Investments v Jugoimport-SDPR Holding Co Ltd*,[267] Waller LJ took the view that if performance is contrary to the domestic public policy of the place of performance, enforcement should be allowed so long as it is not contrary to the domestic public policy of the proper law and/or the curial law.[268] His Lordship also stated that:

[263] *Lemenda*, *supra* n 261, 461.

[264] *Ibid*, 461.

[265] If this conclusion is correct, this means that this particular fact situation could be dealt with under the Rome Convention either on the basis that it is a rule of English law as the applicable law of the contract that the contract is void under Article 8(1) or unenforceable under Article 10(1)(b), or alternatively, that this falls under forum public policy under Article 16.

[266] Any argument that this renders the case (and other enforcement of arbitral award cases considered) irrelevant in this section must be pre-empted by pointing out that the illegality tainting the underlying contract is still significant. "Where public policy is involved, the interposition of an arbitration award does not isolate the successful party's claim from the illegality which gave rise to it": *Soleimany v Soleimany* [1998] 3 WLR 811, 823, *per* Waller LJ.

[267] [1999] 2 Lloyd's Rep 65 (hereafter "*Westacre*"). The case concerned enforcement of an arbitral award made upon a contract for the purchase of personal influence.

[268] *Westacre* [1999] 2 Lloyd's Rep 65, 74.

> "It is legitimate to conclude that there is nothing which offends English public policy if an arbitral tribunal enforces a contract which does not offend the domestic public policy under either the proper law of the contract or its curial law, even if English domestic public policy might have taken a different view."[269]

This suggests that a contract which is against the domestic public policy of the place of performance (Utopia) and the forum (England) but valid according to the governing law of the contract (Ruritanian law) should be enforced. This view seems in principle correct if the place of performance itself only considers the disputed performance something which is merely within its domestic public policy.

The next question then is: what if, regardless of the views of the forum or governing law of the contract, the contract is against the international public policy of the place of performance? Could one argue, by analogy with cases like *Foster v Driscoll* and *Regazzoni v KC Sethia*,[270] that if the place of performance is a friendly and foreign state, the forum should apply the public policy of the place of performance? The answer depends on whether there should be a difference in the treatment meted out to the public policy of the third country in comparison with its mandatory rules.

3. Should There Be a Distinction Between Application of the Mandatory Rules and Public Policy of the *Lex Loci Solutionis*?

Foster and *Regazzoni* involved application of the third country's mandatory rules. Zhilsov argues that public policy is "a set of normative principles underlying a particular legal system" whereas mandatory rules forward "a concrete interest, or policy, which does not necessarily reflect . . . broad public policy principles".[271] Therein lies the difficulty of attempting to treat public policy in the same manner as mandatory rules. Public policy varies and fluctuates depending on the changing values of society and circumstances of the time.[272] Furthermore, no real

[269] [1999] 2 Lloyd's Rep 65, 75. Additionally, his Lordship analysed *Lemenda* and this statement shows that his Lordship interpreted that English public policy was operating as forum public policy in *Lemenda*.

[270] See also *Soleimany v Soleimany* which involved a contract requiring the parties to smuggle carpets out of Iran in contravention of Iranian revenue and export controls. It was stated that an English court will not "enforce a contract governed by the law of a foreign and friendly state, or which requires performance in such a country, if performance is illegal by the law of that country": [1998] 3 WLR 811, 827. Cf *Omnium de traitement et de Valorisation v Hilmarton* [1999] 2 Lloyd's Rep 222.

[271] Zhilsov, *supra* n 13, 101. Although, as Zhilsov goes on to observe, at 102, any mandatory rule may be understood as giving effect to a more general principle of public policy if one takes a broad construction of the rule. See *supra*, section B, for a discussion of the two concepts of public policy and mandatory rules.

[272] *Naylor, Benzon & Co v Krainische Industrie Gesellschaft* [1918] 1 KB 331, 342; *van Duyn v Home Office* Case 41/74 [1974] ECR 1337, para 18; P Molife and H Yu, "The Impact of National Law Elements on International Commercial Arbitration" (2001) 4 *International Arbitration Law Review* 17, 19; Chong, *supra* n 260, 324.

"scale of values" as to what is condemned as being against public policy can be discerned.[273] Given the tenuous and discretionary nature of public policy, it would often be difficult for an English court to gauge whether a foreign court when faced with the same facts would have elected to exercise its discretion to cite its public policy to disapply a particular rule of law. Whereas mandatory rules are of course non-discretionary in nature; therefore, an English court would be confident that the foreign court would have followed a particular course when breach of a mandatory rule occurs.

Quite apart from the practical difficulties involved, there is also a conceptual objection to a court applying another country's public policy. Nygh claims that "there is agreement among civil and common lawyers that the forum will not enforce the public policy of third States".[274] One of the reasons that led to the German reservation against Article 7(1) of the Rome Convention was that the provision would have led to the enforcement of foreign ordre public, "which was considered unacceptable".[275] This refusal to enforce the public policy of another country appears to based on notions of forum sovereignty, that is, that the forum should not have to enforce anyone else's public policy but its own.

This analysis, that there should be a distinction between acts which infringe the public policy of a third country and acts which violate written provisions of the third country, is supported by case law. Phillips J in *Lemenda Trading* recognised the distinction, although unfortunately he did not go on to elaborate on the matter.[276] In *Shaikh Faisal v Swan Hunter*, Chao J noted that cases like *Ralli* and *Regazzoni* specifically related to infringements of the *written* laws of foreign countries.[277] The difference in status between foreign public policy and foreign mandatory rules is also bourne out by *In re Missouri Steamship Company*[278] where the third country involved was the place where the contract was concluded.[279] This case involved a contract, made in Massachusetts, for the transport of cattle from Boston to England in a British ship between an American and a British company. The contract contained a clause excusing the British company for negligence of the master or crew of the ship. English law was the governing law of the contract and the clause was valid by English law but was against public

[273] Kahn-Freund, *supra* n 13, 254 (footnote references omitted): "courts have condemned, as being against public policy foreign contracts in restraint of trade, but not contracts for usurious loans . . . : champertous contracts, but not loans given for gambling; the French laws on guardianship over prodigals and the Maltese law on the maintenance of illegitimate children, but not a claim for the conversion of slaves on the high seas or for the breach of a Brazilian contract for the sale of slaves."

[274] Nygh, *supra* n 25, 207. See also Reynolds, *supra* n 48, 373–74.

[275] Max-Planck Institute for Foreign Private and Private International Law, *supra* n 4, 71.

[276] [1988] QB 448, 456.

[277] [1995] 1 SLR 394, 414 (emphasis added).

[278] (1888) 42 ChD 321.

[279] At the time of the case, it was assumed that where a contract is made in one country to be performed in another, prima facie the governing law of the contract is the *lex loci contractus* in the absence of other factors: (1888) 42 ChD 321, 338, 340–41.

policy by the law of Massachusetts. Since the clause did not violate "positive law",[280] the Court of Appeal ignored the public policy of Massachusetts and upheld the clause.[281] In addition, it is significant that although the Rome Convention provides for application of a third country's mandatory rules,[282] it does not provide for application of a third country's public policy.

Thus, from all the above, it can be concluded that the public policy of a third country holds less sway than its mandatory rules. First, if England is the forum and English law is the governing law of the contract, the domestic public policy of the *lex loci solutionis* is only taken into account if it coincides with English domestic public policy. Secondly, if the governing law of the contract is that of another country, an English court will not take into account the domestic public policy of the *lex loci solutionis.* Thirdly, there are practical and conceptual justifications not to enforce the international public policy of the *lex loci solutionis.* Judicial *dicta* and the lack of a provision catering for a third country's public policy in the Rome Convention would appear to support this proposition.

The only exception to the above would be where the public policy of the *lex loci solutionis* reflects conceptions of international morality.[283] One would assume, however, that in this situation, English law would also consider the contract to be against its public policy and therefore render the contract void or unenforceable as being against forum public policy.[284]

4. Derivation of General Principles Concerning the Application of the Public Policy and Mandatory Rules of Third Countries from Case Law Involving the *Lex Loci Solutionis*

Of all potentially applicable laws of third countries, it is well established that the *lex loci solutionis* has a legitimate interest in being applied to an international contract.[285] It is submitted that the approach taken towards the *lex loci solutionis* shows how the law of a third country should be given effect. Which third country would be considered to have the requisite "close connection" such that it is considered to have a legitimate interest in the contract would depend on the facts of the particular case. However, once the third country has been identified, it is possible to derive general principles from the common law cases discussed above which could guide courts in the exercise of their discretion directly to apply this country's laws.

[280] See (1888) 42 ChD 321, 336, 339 and 342.

[281] In *Mark v Mark* [2005] UKHL 42, [2006] 1 AC 98, 105 (para 11), Lord Hope stated: "our courts do not apply the public policy of a foreign state".

[282] Article 7(1).

[283] Reynolds, *supra* n 48, 378–79; Molife and Yu, *supra* n 272, 20. See J Dolinger, "World Public Policy: Real International Public Policy in the Conflict of Laws" (1982) 17 *Texas International Law Journal* 167, for a conception of a "world public order".

[284] Article 16 of the Rome Convention.

[285] Giuliano–Lagarde Report, *supra* n 32, 27.

Subject to future interpretation of the Rome I Regulation by the European Court of Justice, it is suggested that the following guidelines apply:

1. Application of mandatory rules should not depend on whether the rules came into effect prior to, or after the contract was concluded.
2. Generally, a court does not apply the public policy of another country.

However, as qualifications to proposition 2:

3. If England provides both the forum and governing law of the contract, the court will not enforce a contract which offends both English domestic public policy and the domestic public policy of the third country.
4. If the contract is against both the domestic public policies of England and the third country but is valid according to the public policy of the governing law of the contract, the latter prevails.
5. If the public policy of the third country reflects international conceptions of morality, it should be given effect.

E. Conclusion

The issue of the role that should be accorded to the public policy and mandatory rules of third countries can be broken down into two questions. First, should the courts have the discretion to apply the laws of a third country; and if yes, secondly, how that discretion should be exercised. It has been shown that strong grounds of principle exist for giving effect to a third country's laws and that direct application, as opposed to indirect application, is the preferable mode of application. As to the question of how the discretion should be exercised, specific guidelines as to direct applicability can be found under Article 8(3) of the proposed Rome I Regulation. This provision adopts a position similar to the American interests analysis doctrine whereby the focus is on the nature and objective of the rule. Article 8(3) also gives primacy to parties' legitimate expectations. In addition, further guidelines can be found in the common law English cases concerning the *lex loci solutionis*. The analysis of this area of the law has revealed principles of general application that could guide courts and inform party expectations as to the operation of the discretion. The analysis has in particular revealed that the public policy of a third country plays a more subsidiary role compared to its mandatory rules.

As far as the proposed Rome I Regulation is concerned, it is probable that objections will be raised against the draft Article 8(3), as happened for Article 7(1) of the Rome Convention. It is hoped that this article has shown that Article 8(3) should instead be seen as a welcome development. English law has long admitted that the law of a third country should be given effect indirectly. It is now time to take the next step and embrace direct applicability.